

The State of Fashion 2021



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The State of Fashion 2021



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GLOBAL
ECONOMY

CONSUMER
SHIFTS

FASHION
SYSTEM

BEAUTY
2021

MGFI

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ACKNOWLEDGEMENTS



The authors would like to thank all members of The Business of Fashion and the McKinsey community for their contribution to the research and participation in the BoF-McKinsey State of Fashion Survey, and the many industry experts who generously shared their perspectives during interviews. In particular, we would like to thank: Adam Freede, Albert Chan, Alexander Pavlov, Anant Ahuja, Anne Line Hansen, Anne Pitcher, Charlotte Elstob, Dickson Szeto, Doug Stephens, Elsa Berry, Grégory Boutté, Helena Helmersson, Josh Gardner, Juan Carlos Escribano, Juliet Anammah, Michael Burke, Mike Hu, Nelli Kim, Philip Guarino, Rania Masri, Robert Burke, Sharifa Murdock and Thiago Alonso de Oliveira.

The wider BoF team has also played an instrumental role in creating this report — in particular Amanda Dargan, Anna Rawling, Anouk Vlahovic, Casey Hall, Chelsea Carpenter, Hannah Crump, Kate Vartan, Lauren Sherman, Niamh Coombes, Nick Blunden, Rachel Deeley, Sarah Brown, Sarah Kent, Tamison O'Connor, Venetia van Hoorn Alkema, Victoria Berezchna, Vikram Alexei Kansara and Zoe Suen.

The authors would in particular like to thank Sonja Penttilä and Sarah André from McKinsey's Helsinki and London offices respectively for their critical roles in delivering this report. We also acknowledge the following McKinsey colleagues for their special contributions to the report creation and in-depth articles: Adhiraj Chand, Aimee Kim, Alex Sukharevsky, Andres Avila, Anita Liao, Antonio Gonzalo, Cherry Chen, Claire Gu, Clarisse Magnin, Colin Henry, Colleen Baum, Daniel Zipser, Danielle Bozarth, Ellie Baker, Emanuele Pedrotti, Emily Gerstell, Ekaterina Abramicheva, Ewa Sikora, Fernanda Hoefel, Franck Laizet, Gillian Wright, Hanna Grabenhofer, Hannah Yankelevich, Jihye Lee, John Hooks, Julia Dageförde, Karl-Hendrik Magnus, Karthikeyan Swaminathan, Libbi Lee, Lisa Renaud, Marie Strawczynski, Mekala Krishnan, Miriam Lobis, Nakul Verma, Neha Onteeru, Nicola Montenegro, Patricio Ibanez, Peter Stumpner, Raphael Buck, Rebeca Vega, Rebecca Zhang, Ryan Shultz, Sajal Kohli, Sakina Mehenni, Sophie Marchessou, Susan Lund, Thomas Tochtermann, Tom Skiles, Ulric Jerome, Valerie Van der Voort, Vorah Shin. We'd also like to thank David Wigan and Jonathan Turton for their editorial support, and Adriana Clemens for external relations and communications.

In addition, the authors would like to thank Joanna Zawadzka and Lucinda Scholey for their creative input and direction into this State of Fashion report, Martin Nicolausson for the cover illustration and Getty Images for supplying imagery to bring the findings to life.



In Search of Promise in Perilous Times

For the fashion industry, 2020 was the year in which everything changed. As the coronavirus pandemic sent shockwaves around the world, the industry suffered its worst year on record with almost three quarters of listed companies losing money. Consumer behaviour shifted, supply chains were disrupted and the year approached its end with many regions in the grip of a second wave of infections. A turbulent and worrying year has left us all looking for silver linings — both in life and in business — knowing full well that we will need to make the most of them in the year ahead.

Indeed, according to McKinsey Global Fashion Index analysis, fashion companies will post approximately a 90 percent decline in economic profit in 2020, after a 4 percent rise in 2019. Given the ongoing uncertainty, our predictions for industry performance next year are focused on two scenarios.

The first, more optimistic “Earlier Recovery” scenario envisages that global fashion sales will decline by between 0 and 5 percent in 2021 compared to 2019. This would be predicated on successful virus containment in multiple

geographies and a relatively rapid transition to economic recovery. In this scenario, the industry would return to 2019 levels of activity by the third quarter of 2022.

Our second, “Later Recovery” scenario would see sales growth decline by 10 to 15 percent over the coming year compared with 2019. In this case, the virus would continue to wreak havoc despite widespread containment measures and fashion sales would only revert to 2019 levels in the fourth quarter of 2023.

In either scenario, we expect tough trading conditions to persist next year, in some geographies at least, and for high levels of bankruptcies, store closures and job cuts to continue. At the same time, the pandemic will accelerate trends that were in motion prior to the crisis, as shopping shifts to digital and consumers continue to champion fairness and social justice.

Given the extreme jeopardy facing the industry, there is no simple, standardised playbook for the coming year. Instead, fashion companies must tailor their strategies to fit their individual priorities, market exposure and capabilities.



In other words, deploy your “silver linings strategy” that takes advantage of bright spots in the proverbial storm. The key principles for managing change will be flexibility and agility, alongside operational resilience — a critical capability in an uncertain environment. To inform decision-making, we expect data and analytics to play an increasingly important role, helping companies to track shifts in demand across geographies, categories, channels and value segments.

The pandemic will accelerate trends that were in motion prior to the crisis, as shopping shifts to digital and consumers continue to champion fairness and social justice.

Consumer behaviour has undoubtedly shifted over the past year, as people sheltered from the virus in their homes, travel was restricted and stores were closed around the world. However, as digital consumption continues its dominance and growth in 2021, companies must develop more engaging and social experiences to encourage consumers to connect. At the same time, we anticipate executive teams to increasingly focus on ensuring that digital channels add measurable value to the bottom line, given tight budgets and the need for productivity and efficiency. With tourism in the doldrums for some time to come, brands need to unlock new pockets of demand and tailor assortments to attract more local customers. As they become more conscious of worker welfare issues and the human impact of factory closures, company leaders must uphold the highest ethical business practices and overhaul business models that are exploitative of people and the planet.

Looking forward, the industry should set its sights higher, aiming for a “better normal” across stores, partnerships and assortments.

In a disrupted environment, decision-makers must be bold. They must develop novel strategies for their assortments or product offering, focused on profitability, value, simplicity and downsized collections, rather than discounting and volumes. They also should create a more nuanced assessment of store ROI to manage the crisis in physical retail while implementing a truly omnichannel perspective on store operations.

The pandemic will continue to put supply chains under pressure and executives should be prepared for further shocks in 2021. Brands should secure high-quality and reliable production capacity and make the long-overdue shift to a demand-focused model to operate in this fluid environment. Leveraging volume commitments and strategic alignment with key suppliers will help some suppliers’ financial stability and, in the process, improve the credibility of brands’ ethical commitments.

While there is little doubt that the year ahead will be an arduous one for some fashion industry players, it will also be a year of opportunity for others. Market valuations, a forward-looking measure of expected company success, show that a brighter future lies ahead for companies that are heavily indexed in digital channels and the Asia-Pacific region.

We believe 2021 will bring continuing opportunities in both the value and luxury segments, where the former benefits from consumers trading down in uncertain times, and the latter benefits from a strong recovery in markets like China. Whatever their positioning, stronger players will have an opportunity to seize market share from their peers and, in some cases, acquire their rivals at a bargain price. In this highly tempestuous and increasingly competitive market environment, players across the board will need to reflect carefully (but swiftly) on their next moves. Not every silver lining that emerged from the crisis will lead to a business opportunity and those that do will certainly not last forever.

Navigating Fashion's Rocky Road to Recovery

The past year will go down in history as one of the most challenging for the fashion industry on record, marked by declining sales, shifting customer behaviour and disrupted supply chains. On top of a humanitarian crisis affecting the lives of billions of people, Covid-19 is the catalyst for a deepening economic crisis. Like many other sectors, the fashion industry finds itself in the midst of unprecedented adversity, with revenues and margins under pressure. Yet the shifting landscape is also creating pockets of momentum and, despite the ongoing, widespread impact of the pandemic, some fashion companies are developing new ways to compete.

The pandemic has compounded the demand for all things digital, which in turn has enabled innovation, efficiency and new ways for businesses to scale up. The shift is permanent, and will continue to create opportunities to build slicker, smarter operating models and differentiated customer propositions that are more personalised to each customer. Equally, the crisis has emphasised the need to move to more sustainable and responsible ways of working in all areas of the value chain. As the number of fashion players responding to this need continues to grow, it will prove to be a long-term boon to companies, workers, customers and the planet.

Although more than half of business leaders in our BoF-McKinsey State of Fashion 2021 Survey also expressed concerns about things other than the Covid-19 health and economic crisis for the year ahead, the pandemic recovery timeline did weigh heavily on their minds. We should acknowledge that the mood of fashion business leaders may have evolved in the weeks that transpired since the survey, especially as the pandemic worsens again in the fourth quarter of 2020 — with government responses including more severe social distancing measures in Europe, the threat of new lockdowns across numerous regions and mass-testing in some Chinese provinces. Nevertheless, the collective sentiment of fashion executives gleaned from our survey does constitute a compelling yardstick against which to measure business leaders' predictions and expectations for the year ahead.

Naturally, business leaders across the board hope for the effects of Covid-19 to dissipate and for the global economy to recover as quickly as possible. McKinsey Fashion Scenarios analysis for the industry over the next year anticipates that, in an Earlier Recovery scenario, the virus will be effectively controlled, thanks to a strong public health response (based on information available September 2020).¹ In this scenario, government

Exhibit 1:

Fashion executives are divided on the outlook for the industry in 2021

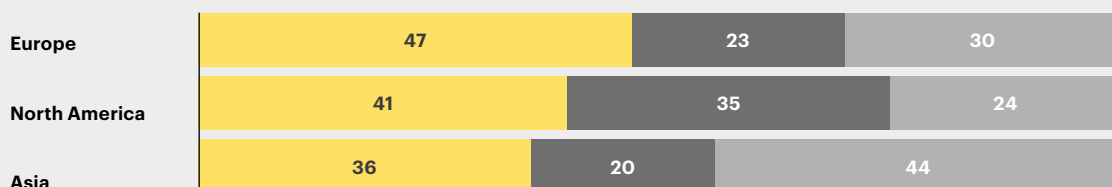
% OF FASHION EXECUTIVE RESPONDENTS, EXPECTATIONS FOR THE CONDITION OF THE FASHION INDUSTRY IN 2021 RELATIVE TO 2020

BY SEGMENT

Worse Same Better



BY GEOGRAPHY

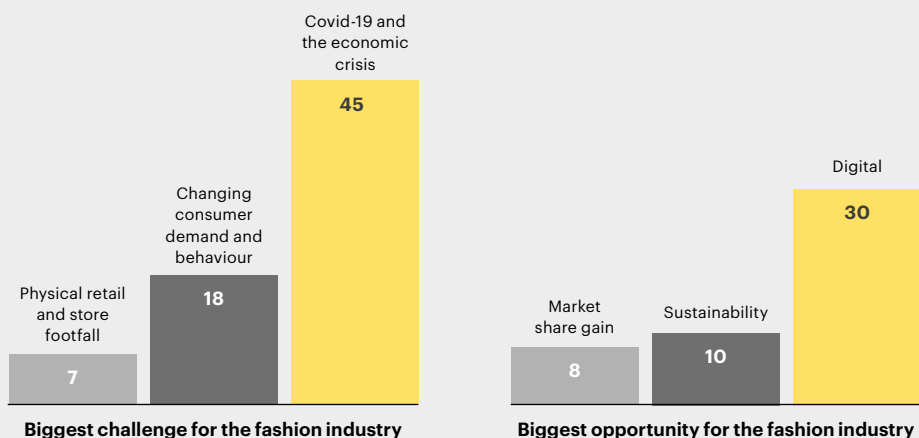


SOURCE: BOF – MCKINSEY STATE OF FASHION 2021 SURVEY

Exhibit 2:

Fashion executives expect Covid-19 and the economic crisis to be the biggest challenge in 2021 and digital to be the biggest opportunity

TOP THREE ANSWERS, % OF RESPONDENTS WHO MENTIONED THE WORD



SOURCE: BOF – MCKINSEY STATE OF FASHION 2021 SURVEY

INDUSTRY OUTLOOK

interventions will partially offset economic impact and global travel will pick up along with the possibility of larger social gatherings. The global growth outlook for fashion sales in this scenario determines that recovery would be achieved by the third quarter of 2022, with China leading the way with 5 to 10 percent sales growth in 2021 compared to 2019. Europe, on the other hand, would expect to continue to see lower sales in 2021 as international tourists stay at home, with sales down 2 to 7 percent compared to 2019. With footfall remaining low, pre-Covid levels of activity in Europe are unlikely to return before the third quarter of 2022. This scenario includes a similar trajectory for the US, with sales down 7 to 12 percent in 2021 compared to 2019, and recovery to pre-Covid sales only expected by the first quarter of 2023.

The primary driver of growth in the coming year will continue to be digital channels, reflecting the fact that people in many countries remain reluctant to gather in crowded environments. The Earlier Recovery scenario anticipates dynamic digital growth across geographies in 2021 compared to 2019, with more than 30 percent online growth in Europe and the US and over 20 percent growth in the already highly digitised Chinese market.²

The primary driver of growth in the coming year will continue to be digital channels, reflecting the fact that people in many countries remain reluctant to gather in crowded environments.

However, less favourable recovery scenarios must also be considered if there is a delay to a widely available vaccine. In this case, the virus would persist in some regions and new waves of lockdowns could take hold, accompanied by only partially effective government responses and ongoing travel restrictions, further embedding the consumer behaviour developed during the pandemic. If this more pessimistic Later Recovery

scenario were to materialise, a deeper dip in sales in 2021 and slower global economic recovery would be anticipated. In this case, the US would see sales decline by 22 to 27 percent in 2021 compared to 2019, and pre-Covid performance in the country would not return until after 2025. Although significantly impacted, Europe would fare slightly better than the US overall in this scenario, with sales down 14 to 19 percent compared to 2019. However, the European luxury segment would suffer a considerable hit. If new lockdowns were to be implemented and travel restrictions persist, luxury sales in Europe could drop up to 40 percent and only recover to their pre-crisis level by the third quarter of 2023.

There are, of course, a multitude of intermediate scenarios in between the two ends of the spectrum, each containing a combination of positive and negative effects set against the backdrop of an industry striving to recover its equilibrium. However, in all cases, we anticipate significant variation between geographies, with as much as a two- to four-year lag between fast- and slow-recovering markets.

On top of subdued sales, we expect industry players will see deep and long-lasting changes to both consumer demand and ways of working. Among potential short-term challenges, brands will need to manage a category shift towards casualwear and the continuing pressure on luxury, as well as shorter production cycles and cash constraints that lead to a slowdown in investments.

Set against this backdrop, the strategic outlook among business leaders is uneven, reflecting the diverse trends the industry faced even before the pandemic. Across all value segments, a larger proportion of executives in the BoF-McKinsey State of Fashion 2021 Survey are pessimistic rather than optimistic about the year ahead, but 32 percent of respondents still expect the industry to evolve positively next year.³ In line with pre-crisis attitudes, 31 percent of executives in the luxury segment and 36 percent in the value segment have a positive outlook for 2021, while only

22 percent of executives in the mid-market believe things will get better. In the luxury segment specifically, fashion executives express more confidence than McKinsey's Earlier Recovery scenario, which forecasts a decline of global luxury sales by 12 to 17 percent in 2021 compared to 2019, and up to a 28 percent decline in Europe. The highest confidence is around the value segment, with 36 percent of executives projecting an improvement and another 23 percent predicting little change. This reflects the impact of the pandemic on consumers across different income brackets, as well as the more established appetite for cheaper fashion, now partially offset by rising demand for quality and durability.

In line with regional recovery rates so far, executives from Asia are the most confident about the upcoming year, with almost half sharing a positive outlook. The vision for 2021 is less optimistic in the west, with only around a third of European executives and a quarter of US executives expecting the state of the fashion industry next year to improve. The sentiment of European executives is the bleakest, with almost half saying conditions will get worse, compared to 41 percent of executives in the US.

The extent to which these concerns are weighing on executives is shown in their choice of the top three words to describe the conditions we can expect for the fashion industry in 2021: "uncertain," "challenging" and "disruptive."⁴ Given the clouds that shroud the economic outlook this year, digital is seen by a third of executives as a silver lining that presents the biggest opportunity in 2021. Indeed, almost all businesses anticipate their online revenues to rise next year, with 26 percent of executives projecting a gain of 50 percent or more and nearly half of executives projecting growth of 30 percent or more. The digital opportunity in e-commerce as well as in the digitisation of business processes and operations is the most cited opportunity by far. Sustainability follows in second place, with 1 out of 10 executives citing it as an area of growth, underscoring the

mindset shift towards sustainability that has begun to take place over the last few years. Optimism about digital and sustainability chimes with the widely held view that, despite the disruption of the pandemic, these trends will accelerate and, in turn, lead to a reset of the fashion industry.

Digital is seen by a third of executives as a silver lining that presents the biggest opportunity in 2021.

With the benefit of hindsight, we also asked survey respondents to reflect on the relevance of forward-looking sentiments gathered last year. Of the themes we highlighted in last year's State of Fashion report, executives state that those impacting their business the most in 2020 were "Next Gen Social," "Sustainability First" and, in third place, "On High Alert" of recession risk. These choices reveal how the Covid-19 crisis has accentuated trends that were forecasted in last year's report and catalysed them in a way and at a pace no one could have predicted.

The 10 themes that will come to define 2021 suggest the beginning of a new chapter for the global fashion industry. 2020 has been a year of colossal change. What is clear is that the fashion industry, like many other sectors, will certainly exit this crisis in a very different form than that in which it entered. Depending on their sizes, geographies and the segments in which they operate, some players can anticipate a brighter outlook in the year ahead. Others will not.

In any event, there is no likely scenario which predicts a strong recovery in 2021. The upcoming year acts as a bridge between two different states of the industry. As such, the 10 themes for The State of Fashion 2021 each highlight a major disruption sparked by the pandemic. In order to cross the bridge into fashion's new world, executives should pay heed, as each theme offers an urgent imperative for the year ahead.

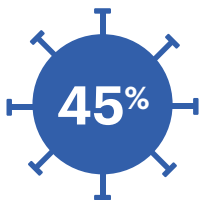
The State of

GLOBAL ECONOMY

01.

Living with the Virus

The Covid-19 crisis has impacted the lives and livelihoods of millions of people, while disrupting international trade, travel, the economy and consumer behaviour. To continue to manage unprecedented levels of uncertainty in the year ahead, companies should rewire their operating models to enable flexibility and faster decision-making, and balance speed against discipline in the pursuit of innovation.

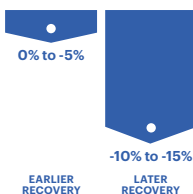


Covid-19 and the economic crisis is the top challenge for 2021 for 45% of fashion executives and stakeholders surveyed

02.

Diminished Demand

Following the deepest recession in decades, the global economy is expected to partially recover next year but economic growth will remain diminished relative to pre-pandemic levels. Since demand for fashion is also unlikely to bounce back due to restrained spending power amid unemployment and rising inequality, companies should seize new opportunities and double down on outperforming categories, channels and territories.



Global fashion sales in 2021 could be **below 2019 levels** by as much as 15 percent

CONSUMER SHIFTS

03.

Digital Sprint

Digital adoption has soared during the pandemic, with many brands finally going online and enthusiasts embracing digital innovations like livestreaming, customer service video chat and social shopping. As online penetration accelerates and shoppers demand ever-more sophisticated digital interactions, fashion players must optimise the online experience and channel mix while finding persuasive ways to integrate the human touch.



71% of fashion executives expect their **online business to grow by 20% or more** in 2021

04.

Seeking Justice

With garment workers, sales assistants and other lower-paid workers operating at the sharp end of the crisis, consumers have become more aware of the plight of vulnerable employees in the fashion value chain. As momentum for change builds alongside campaigns to end exploitation, consumers will expect companies to offer more dignity, security and justice to workers throughout the global industry.



55% of consumers expect fashion brands to **care for the health of employees** in times of crisis

05.

Travel Interrupted

The travel retail sector remains severely disrupted and destination shopping suffered throughout 2020. With international tourism expected to remain subdued next year and shoppers experiencing further interruptions to travel, companies will need to engage better with local consumers, make strategic investments in markets witnessing a stronger recovery and unlock new opportunities to keep customers shopping.



66% of fashion executives expect **travel retail sales to recover** their former growth levels only within **2 or 3 years**

Fashion 2021

FASHION SYSTEM

06.

Less is More

After demonstrating that more products and collections do not necessarily yield better financial results, Covid-19 highlighted the need for a shift in the profitability mindset. Companies need to reduce complexity and find ways to increase full-price sell-through to reduce inventory levels by taking a demand-focused approach to their assortment strategy, while boosting flexible in-season reactivity for both new products and replenishment.

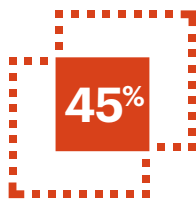


58% of fashion executives consider **assortment planning** to be a key area for data and analytics in 2021

07.

Opportunistic Investment

Performance polarisation in the fashion industry accelerated during the pandemic as the gap widened between the best-performing companies and the rest. With some players already bankrupt and others kept afloat by government subsidies, we expect M&A activity to increase as companies manoeuvre to take market share, unlock new opportunities and expand capabilities.



45% of fashion executives expect **market share redistribution** to be a top theme in 2021

08.

Deeper Partnerships

By exposing the vulnerability of procurement partners, the weakness of contracts and the risks of a concentrated supplier footprint, the crisis accelerated many of the changes that companies were already making to rebalance their supply chain. To mitigate future ruptures, fashion players should move away from transactional relationships in favour of deeper partnerships that bring greater agility and accountability.



35% of fashion executives expect **resilience and partnerships in the supply chain** to be a top theme in 2021

09.

Retail ROI

Physical retail has been in a downward spiral for years and the number of permanent store closures will continue to rise in the post-pandemic period, compelling fashion players to rethink their retail footprints. Amplified by a potential power shift from landlords to retailers and the need to seamlessly embed digital, companies will need to make tough choices to improve ROI at store level.



Approximately half of European consumers have **shopped less in physical stores** since lockdowns started

10.

Work Revolution

Prompted by fundamental changes in the way companies worked during the pandemic and the need to drive performance in the years to come, an enduring new model for work is likely to emerge. Companies should therefore refine their blends of remote and on-premises work, invest in reskilling talent and instil a greater sense of shared purpose and belonging for employees who continue to reconsider their own priorities.



89% of fashion executives expect a **hybrid model of working** to be part of the new normal

GLOBAL ECONOMY

01. LIVING WITH THE VIRUS

02. DIMINISHED DEMAND



01. LIVING WITH THE VIRUS

The Covid-19 crisis has impacted the lives and livelihoods of millions of people, while disrupting international trade, travel, the economy and consumer behaviour. To continue to manage unprecedented levels of uncertainty in the year ahead, companies should rewire their operating models to enable flexibility and faster decision-making, and balance speed against discipline in the pursuit of innovation.

The pandemic has had a destructive impact on the global economy. It is now certain that there will be an exceptional slowdown in economic growth in 2020, with the International Monetary Fund predicting that global GDP will be 6.5 percent lower than its pre-pandemic projection, with variability across regions. At the same time, governments are accumulating huge debts. In just one year, global public debt stocks are projected to jump by an astonishing 13 percent to 96 percent of gross world product, with longer-term effects likely to be tax rises, restricted spending and slower growth.⁵ Furthermore, few economists predict a recovery to pre-crisis levels before the third quarter of 2022, and even that prediction is riddled with uncertainty.

International tourist arrivals are expected to contract by 60 to 80 percent in 2020 and international tourism is forecast to remain subdued until 2023 or 2024.

Recovery will likely fall somewhere between bullish and bearish scenarios for 2021, based on McKinsey Global Institute analysis in partnership with Oxford Economics (based on information available September 2020). In a more optimistic

future scenario, the global economy could return to 2019 levels of activity by the third or last quarter of 2021, with differentiated growth trajectories across regions. In more pessimistic future scenarios, recovery will take longer and businesses will face continued volatility in supply and demand for multiple years.

One segment hit particularly hard by the crisis has been international travel, which has almost ground to a halt in some geographies. The severity of the impact was summed up by Procter & Gamble (P&G) Vice Chairman Jon Moeller, when he told investors on an earnings call in April 2020 that the travel retail business in Asia — which underpins P&G brands like SK-II — was simply “gone.”⁶ For fashion and beauty players that are reliant on the travelling consumer, there will continue to be concern next year. International tourist arrivals are expected to contract by 60 to 80 percent in 2020 and McKinsey forecasts that international tourism will remain subdued until 2023 or 2024.^{7,8}

Cross-border trade also continued to slow significantly in 2020, with port and airport closures disrupting flows, which adds to challenges caused by ongoing trade tensions and tariff disputes, including the deteriorating relationship between China and the US and the unknown impact of Brexit on UK-EU flows.

In the wake of these crosscurrents, the fashion industry will continue to face a period of unprecedented challenges. With that in mind, resilience should be at the top of executives' agendas. History reveals just how important it is during times of crisis.

In the aftermath of the 2008 financial crisis, companies that were able to foster resilience through operational and financial flexibility generated higher total returns to shareholders (Exhibit 3). According to McKinsey analysis, this manifested across four key levers.⁹ The first was investment in top-line growth as early as possible, which accelerated the rebound and led to revenue increases of up to 30 percent compared with those of non-resilient players. Second, companies that addressed key structural costs were able to achieve higher productivity — resilient players reduced operating costs by as much as threefold. Third, a methodical approach to acquisitions and disposals led to better performance: specifically, divesting and investing early in the recovery paid dividends. Finally, deleveraging was a consistently productive strategy, with less indebted companies faring better than their peers.

More than 80 percent of leaders at consumer and retail companies report they are now making and implementing major decisions faster than before.

The four levers can also be seen through the twin rubrics of agility and discipline. Fashion companies that adopt these overarching principles and turn them into concrete strategies are likely to emerge from the crisis in better shape. Indeed, many are already doing so. More than 80 percent of leaders at consumer and retail companies report they are now making and implementing major decisions faster than before.¹⁰ In March 2020, US jewellery brand Kendra Scott rapidly transformed its 108 US stores into fulfilment centres — a response to

strains on existing centres due to social distancing measures.¹¹ British retailer John Lewis announced in the summer it would open concessions with fast-growing indoor spinning brand Peloton, rapidly responding to the at-home fitness trend that boomed during the pandemic.¹²

As the crisis continues to unfold, brands must shape their strategies by quickly grasping which trends will remain after recovery and which will dissipate. In any event, investment in data and analytics is likely to reap benefits. Armed with customer insights, companies can reset their long-term strategies and redirect investment into opportunities that will outlast the pandemic.

According to our BoF-McKinsey State of Fashion 2021 Survey, the most fertile ground for these opportunities will be in the areas of digital and sustainability, which were chosen by 30 percent and 10 percent of executives respectively (see Digital Sprint on page 35).

The emphasis on sustainability is also reflected in consumer sentiment. More than three in five consumers in a McKinsey survey ran in May 2020 said brands' promotion of sustainability was an important factor in their purchasing decisions.^{13 14} In response, numerous companies are stepping up their sustainability efforts. Timberland is aiming to source all of its natural materials from regenerative agriculture by 2030,¹⁵ while British department store Selfridges has unveiled bold new sustainability goals, promising to stop stocking products that are not compliant with its new sourcing standards by 2025,¹⁶ and Allbirds has started labelling the carbon footprint of each of its products.¹⁷

In 2021, we expect winning brands to be those that can define clear, long-term ambitions, while demonstrating enough flexibility, speed and agility to navigate an uncertain short-term future. Brands should reshape their operating models to adapt to the faster pace of change and sustain those effective new working practices that have emerged from the crisis. Since adaptability will be key to all of this, brands should identify the threats to

01. LIVING WITH THE VIRUS

their businesses and prepare strategic responses across multiple scenarios in order to counter uncertainty and facilitate fast decision-making. Building cross-functional teams that are informed by strategic priorities will give brands the necessary agility to respond quickly and capture market opportunities.

Fashion executives need to set aside their traditional approaches to budgeting and strategic planning to maximise their organisation's responsiveness in the months ahead. Leaders should systematically assess the impact of strategic initiatives launched since the start of the pandemic and re-evaluate their initial assumptions about factors like sales and volumes based on real-time results. Learnings from 2020 should be used to stress-test plans for 2021 and identify key priorities for all potential future scenarios. To support this fresh perspective on planning, fashion leaders

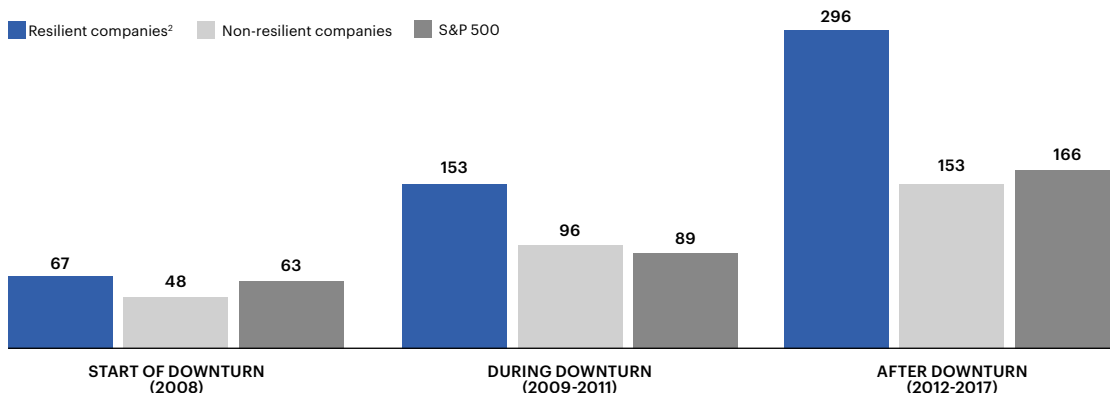
will have to reimagine budgeting from a zero-base approach, with pre-defined funds allocated to different possible scenarios. While brands should cut down on secondary spending where possible, leaders should be careful not to trim key growth investments, notably digital ones, in order to remain relevant both during and after the downturn.

We expect in the coming year that leading fashion executives will step up their execution excellence and delegate decision-making more efficiently to ensure better accountability. The pandemic has already prompted some players to recalibrate chains of command, simplifying decision-making and enabling greater autonomy down the hierarchy and to regional centres. And in an increasingly uncertain world, fashion executives should also ensure continuous dialogue and information-sharing with employees and shareholders, fostering communication across the organisation.

Exhibit 3:

Resilient fashion companies have historically widened the gap with the rest after an economic downturn

TOTAL SHAREHOLDER RETURN (TSR) PERFORMANCE FOR COMPANIES IN THE TEXTILES, APPAREL AND LUXURY GOODS INDUSTRY¹



¹ Calculated as market capitalisation weighted TSR index of Resilient and Non-Resilient companies in the Textiles, Apparel and Luxury Goods industry, includes 862 global Textiles, Apparel and Luxury Goods companies that were trading between 2007-2017

² Resilient companies defined as having excess TSR CAGR (vs S&P 500 index) between 2007-2017; companies in the remaining 4 quintiles are classified as non-resilient companies

SOURCE: MCKINSEY CORPORATE FINANCE PRACTICE

Jumia: Balancing Speed with Discipline in a Crisis



Juliet Anammah
Chairwoman, Jumia Nigeria;
Head of Institutional Affairs, Jumia Group

Dubbed Africa's answer to Amazon, Jumia has seized the e-commerce opportunity in dynamic markets like Nigeria, Kenya, Senegal, Morocco and Egypt, though it didn't achieve the growth levels analysts expected during the pandemic. Next year, the e-tailer will be even more disciplined about its path to profitability, suggests Juliet Anammah, a veteran executive at the group.

— *by Robb Young*

Less than a year after ringing the ceremonial bell at the New York Stock Exchange to celebrate the IPO of the first African start-up listed there, Juliet Anammah and her colleagues were devising an emergency action plan to liaise with health ministries in the eleven countries where Jumia operates. The recently promoted executive was used to representing the e-commerce heavyweight at the highest levels of negotiations with governments and global business leaders, but nothing could have prepared her for the agility and diplomatic resolve that she and leaders like her needed during the pandemic.

In more ways than one, 2020 has been a rollercoaster year for "the Amazon of Africa." But as an e-commerce platform

01. LIVING WITH THE VIRUS

selling everything from luggage to laptops and food to footwear, Jumia remains an attractive channel for brands to access consumers on the continent, and Anammah remains bullish about the firm's prospects in 2021.

How much more room is there for Jumia to grow in the year ahead and what role do you now play in the continent's online acceleration? Is it different from the role you played in the first eight years of growth?

We still have decades of growth ahead of us. If you look at the penetration of e-commerce on the continent, at best, it's still about two percent, three percent. There is still a whole lot of upside in terms of more transactions that we can bring online, and we are addressing this in multiple dimensions. We're increasing the variety of products that can be found on Jumia. Today, a consumer can buy virtually anything on Jumia [not just] fashion products and beauty products. They can buy airtime [for mobile phones] and pay bills on Jumia. And within each of the categories where we operate, the assortment is growing every year. All of these are things that are relevant [in terms of our growth trajectory in the context of Africa's ever-] increasing [e-commerce] penetration rate.

Some people credit Jumia with "revolutionising" e-commerce in Africa. Others accuse it of being a clone of Amazon, citing the successive roll-out of services like Jumia Prime, Jumia Express and so on. What do you say?

I'd say: one, you don't reinvent the wheel. It makes no sense to

go and start rewriting the rule book on how e-commerce works. Consumers [around the world] are already used to a certain way of interacting with e-commerce platforms. It's important that you give them something that they're familiar with — but adapt it. So we said, "How will consumers trust that the item will be delivered to them?" because logistics is a big challenge in Africa. We had to solve the trust question by creating a cash on delivery option with three attempts to make a delivery, a payment solution and all kinds of special [service infrastructure]. I call it adapting the e-commerce model for the African environment and customising it to the African consumer. We couldn't just take a model from another region, and then implant it in Africa. That wouldn't have worked. But for people to now say, "Oh, this is the Amazon of Africa," it means they recognise that what we're doing for Africa is what Amazon did in the US. So, to the extent that [the "Amazon of Africa" nickname] makes me feel anything, it makes me feel happy.

Jumia provides a sales platform for consumers in Nigeria, South Africa, Kenya, Côte d'Ivoire, Ghana, Senegal, Uganda, Morocco, Algeria, Tunisia and Egypt. How do you manage to optimise the customer experience for such a hugely diverse group of markets with different regulatory environments and different consumer behaviours across that colossal expanse of the continent?

We didn't have the luxury of having big, established logistics players that could reach every

part of the country who were also willing to take cash on delivery, so we had to create a network of third-party logistics providers. We just built the systems that would allow us to then leverage that and the data systems for it.

That's impressive. But how do you localise Jumia's assortment across African nations with so many different wardrobe preferences — not only between the different markets but also within each market?

Assortment differs [by market] because we operate across 11 countries [but] there are certain brands that we have partnerships with on a global level... But if you take Nigeria, for example, there are small local designer outlets producing affordably priced clothing for work [and] some creating African native fashion for special occasions. We also customise our marketing. In certain markets, YouTube is important and others it is different social media.

To what extent do you feel that Jumia's path to profitability has been impacted by Covid-19? How do things look now in the run-up to 2021?

During the Covid pandemic we didn't need to spend as much on sales and advertising as we would have done in normal times [so] overall, you'll find that net losses were reduced between 2019 to 2020. Of course, we had taken some decisions earlier on about staff costs and other operational expenditures that matured by the second quarter of 2020, which held our gross merchandise value (GMV) expenses down further. In terms of the top line, it wasn't phenomenal growth.

EXECUTIVE INTERVIEW

Some people expected us to see triple-digit growth over 2020 versus 2019. Their perception was that the whole of Africa was ordering online, which is not the case. You need to understand that it's a long-term play for e-commerce. It's not a two-year stint and you march on to profitability. It takes a pretty long time. Where we are right now, we're very much focused on our account profitability.

You were the CEO of Jumia Nigeria for four years before being appointed chairwoman in 2020. How have you led your team to source the right products for the mass market?

We are a platform for everyone. We're agnostic. So you have top brands from Procter & Gamble, and then you also have the distributors, the small-size wholesalers that bring a lot more variety of brands in their portfolio. Then of course, we have local sellers who bring rich diversity even

assortment and product designs that recognise the specific price needs of our consumers at this point in time, then those products will be successful on our platform.

You've said that luxury brands are definitely not a priority for Jumia, but to what extent is Jumia interested in negotiating more deals with global fashion brands from the US or Europe, assuming of course that their assortment is right and their price point hits your sweet spot?

The commercial team are constantly looking at new partnerships. Fashion is one of the top five or six categories where we're definitely very hungry for new partnerships. Having said that, the sweet spot, if I remember rightly, it used to be between \$10 to \$20. Of course, you also have consumers who would want higher price points and product designs. But what you may consider a lower price point from

I think it's more than that. It's really taking a proper look at the entire value chain and asking, okay, where do we source? Where do we produce these items and using fabrics at what price? Who are the middlemen and key channel partners before it gets to Jumia? Fashion brands [that are interested in partnering with us] have to look at it very critically to see where the opportunities are to really drive the price down. Brand executives would need to be assertive about saying, "We are focusing on Africa and Africa is an opportunity for us." If this is the mindset and objective at corporate level, then you have the corporate backing which means you also have the motivation and incentive to really look at the entire value chain and route to market and figure out how to make sure that products can ultimately be sold on Jumia at \$20 and \$25. At the end of the day, it's about the different [and sometimes competing emerging market] priorities that are on the CEO's table. Apart from Asia, they also have the Latin American market opportunity. So if there is no hunger at corporate headquarters saying, "We want to grow in Africa," then it's not going to work.

Going forward, how much heat will Jumia feel from online competitors like Konga in Nigeria or Takealot in South Africa?

There's so much to be done on the continent that, if anything, competition is welcome because everybody understands there is huge, huge potential ahead of us.

This interview has been edited and condensed. Additional reporting by Zoe Suen.

"It's a long-term play for e-commerce. It's not a two-year stint and you march on to profitability."

though they may only have 10 to 50 SKUs in total. You also have to remember, these are countries going through a very difficult period now. [African] consumer purchasing power is increasingly going to be squeezed so we need to bring an assortment that's relevant to the consumer, in terms of the price-performance ratio. Whether it's a fast-fashion brand from China, a big brand from Turkey, or an established brand from [Europe or the US], to the extent that they have

a US or a UK perspective, is still relatively pricy on the continent. It's looking at how brands rework their route to market in such a way that they can make products available within a \$20, \$25, \$30 price point reach. What I think would be difficult is if those brands use their existing route to market, they may not be able to deliver those price points.

Are you referring to the added margins incurred due to distributors?

02. DIMINISHED DEMAND

Following the deepest recession in decades, the global economy is expected to partially recover next year but economic growth will remain diminished relative to pre-pandemic levels. Since demand for fashion is also unlikely to bounce back due to restrained spending power amid unemployment and rising inequality, companies should seize new opportunities and double down on outperforming categories, channels and territories.

Few fashion companies were spared from a fall in consumer spending as demand for discretionary goods plummeted during global lockdowns. As a result, the entire fashion industry revenue pool in 2020 will shrink by 15 to 20 percent in an Earlier Recovery scenario, or by 25 to 30 percent in a Later Recovery scenario, according to McKinsey Fashion Scenarios analysis (based on information available September 2020).¹⁸ This reflects the extreme severity of the global recession, which has been described by the International Monetary Fund (IMF) as the worst since the 1930s Great Depression.¹⁹

However, the impact on the fashion industry will be uneven. Europe is expected to be the worst-hit region in 2020, witnessing a 22 to 35 percent decline in sales, followed by the US with a 17 to 32 percent decline. China will likely be less impacted, seeing sales drop by 7 to 20 percent.²⁰

Results from McKinsey's consumer sentiment surveys support this prognosis. Consumer intent to shop for apparel, footwear, accessories and jewellery in September 2020 was still down by 27 to 35 percent in the US.²¹ Meanwhile, consumer intent in China, which is further ahead in its recovery, turned to positive 4 percent in June.²²

The challenging environment born out of the unprecedented events of 2020 will linger into 2021, with global fashion sales projected to be below 2019 levels by as much as 15 percent in the Later Recovery scenario. A full recovery of global fashion sales to pre-crisis levels will not come until the third quarter of 2022 at the earliest, according to McKinsey's Fashion Scenarios.²³ Indeed, fashion is expected to be among the slowest-recovering discretionary spend categories.

A full recovery of global fashion sales to pre-crisis levels will not come until the third quarter of 2022 at the earliest.

"Undoubtedly the apparel market has shrunk in 2020. People aren't shopping in stores — they're sitting at home questioning why they have so many items in their closets," said Elizabeth Spaulding,²⁴ president of US-based online personal styling service Stitch Fix, which laid off 1,400 stylists in California and is hiring or relocating 2,000 stylists across other US states throughout 2020.²⁵ "We've just seen extraordinarily accelerated demand [since June and] some of the highest

retention rates that we've seen in many years, which we think is a signal of people saying, 'this is the way I want to shop in the future.'"

There are other shards of light among the gloom, with spending in some regions expected to pick up faster than others. Fashion sales in China are predicted to return to pre-crisis levels by as early as the fourth quarter of 2020 or, at the latest, by the first quarter of 2021. In the Earlier Recovery scenario, European fashion spend will partially recover in 2021 (down by only 2 percent to 7 percent compared with 2019), with Germany as a bright spot that could reach pre-crisis spending levels by the third quarter of 2021. However, the US appears set for a slow recovery in 2021, with fashion sales 7 percent to 12 percent down from 2019, even in the Earlier Recovery scenario.²⁶

The pace of recovery will also vary across fashion categories and value segments, with some pockets of growth despite the continuing economic challenges. Looking at market valuations, the value and discount segments are the healthiest. By October 2020, value and discount players had a market capitalisation of 5 percent more than in December 2019, while the same figure was -12 percent for luxury companies and -16 percent for the value segment. This reflects longer-term industry trends towards polarisation across value segments.²⁷

Appetite for expensive discretionary items remains high among some wealthy consumers and is expected to remain so in 2021.

Earnings reports suggest the luxury segment in fashion suffered less than others in early 2020. Luxury revenues and margins were down 26 percent and 15 percentage points respectively in the reporting quarters falling between February and June, while the overall market was down 34 percent

by revenues and 21 percentage points by margin.²⁸

Indeed, appetite for expensive discretionary items is still high among some wealthy consumers and is expected to remain so in 2021. Kering has reported a steady recovery in mainland China, with some brands returning to growth already,²⁹ while store re-openings there suggest there has also been a release of pent-up demand for luxury. Indeed, China is driving recovery in the luxury segment as Chinese luxury sales already recovered to 2019 levels in the second quarter of 2020 and are estimated to be up 10 to 30 percent in 2021, in comparison to 2019. This reflects a shift of luxury spend into China, while the other major economies will take longer to recover.³⁰

Lockdowns and restrictions on movement have strongly influenced consumer choices around what to wear.

At the other end of the scale, growing inequality and financial uncertainty are prompting consumers to seek out value. The IMF is among the organisations to note that Covid-19 is likely to increase income inequality, with poorer people more vulnerable to furloughs and layoffs and less able to work from home.³¹ Overall unemployment is estimated to be 50 to 83 percent higher in OECD countries in 2021 than in 2019, depending on scenario.³² Some 20 percent of US consumers expect the crisis to affect their personal or household finances for more than a year, and 27 percent say they will trade down to more inexpensive items to save money.³³

Lockdowns and restrictions on movement have strongly influenced consumer choices around what to wear, too. The formalwear category, which was slowing down prior to the crisis, has been on a steeper downward slope since the pandemic started. Many players have been suffering, with Brooks Brothers filing for bankruptcy, Hugo Boss

02. DIMINISHED DEMAND

reporting a year-on-year sales decline of 59 percent in the second quarter,³⁴ and T. M. Lewin and Moss Bros closing stores, citing customers working from home and cancellations of major events as the cause of the decline in suit shopping.³⁵ According to the BoF-McKinsey State of Fashion 2021 Survey, 68 percent of fashion executives expect shopping for occasion wear to recover earliest by the end of 2021, while in formalwear, as many as 38 percent say it will never return to pre-Covid-19 growth levels.³⁶ Stefano Canali, president and chief executive of the luxury menswear brand Canali, said in June 2020 that he believes the classic, traditional suit is “definitely in a deep crisis” that will outlast the pandemic.³⁷

We expect increased consumer interest in health and wellness to persist beyond the pandemic, meaning demand for athleisure and activewear will likely continue to be strong in 2021. Athleisure and activewear brands have not been immune to declining sales, but US sales were down just 2 to 3 percent year-on-year in August, compared with double-digit declines in other apparel categories, according to Earnest Research.³⁸ Investors appear to be more optimistic about the outlook for sportswear than other apparel categories: by October 2020, sportswear company stocks had exceeded their pre-crisis-levels by 7 percent, while the non-sportswear clothing category was down 18 percent.³⁹

One driver for the category is an uptick in cycling as an alternative mode of transport. Sales of bicycles doubled in the US and grew in many other countries during the spring lockdown, and the growing number of cities implementing more bicycle-friendly mobility concepts points in the direction of sustained demand for bikewear and waterproof clothes.⁴⁰ In early 2020, luxury brand Moncler even partnered with the eBike start-up Mate for one of its Genius collaboration collections.

More broadly speaking, the casualisation trend that was already in motion before the pandemic and that accelerated throughout 2020 is

likely to emerge as a dominant force across many fashion categories in 2021. Indeed, companies that were able to ride the surge in demand for casual or athletic clothing fared better than analyst expectations in the second quarter of 2020, such as American Eagle Outfitters-owned Aerie which launched new athleisure brand Offline in July.⁴¹ With more flexible working arrangements on the horizon for the year ahead, casualwear is only set to grow in importance for many fashion players.

Some companies have been quick to pivot to these new consumer dynamics. Dolce & Gabbana's Alta Moda (haute couture) collection normally sells lavish, custom-made occasion wear. In the season that fell during lockdown, elaborate gowns and eveningwear were replaced by a capsule collection of kimonos, kaftans and other easier-to-wear items.⁴² Meanwhile, formalwear brand Reiss took a hint from the success of its more leisurewear-focused pieces and launched a new “luxe leisure” collection.⁴³

The casualisation trend that was already in motion before the pandemic and that accelerated throughout 2020 is likely to emerge as a dominant force across many fashion categories in 2021.

Looking forward, as demand remains subdued in 2021, fashion companies should aim to mirror shifts in consumer behaviour across their product offering and double down on growth hotspots. Strategic plans should reflect “heat maps” of better-performing geographies, categories and value segments, with ideas road-mapped so that companies can respond quickly to opportunities when and where they arise. Investment in marketing, new stores and staffing will be best directed at geographies in which demand is picking up fastest. Product marketing campaigns should focus on in-demand categories such as athleisure

and loungewear and be given a spotlight in prime locations like online landing pages.

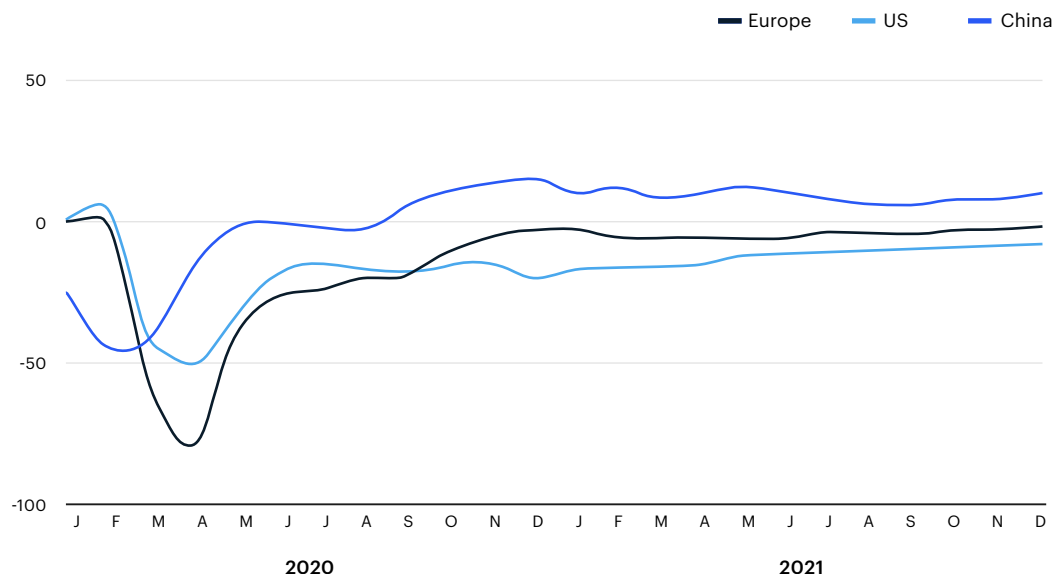
Brands in formalwear categories, meanwhile, can opt to rebalance assortments towards a higher proportion of easier-to-wear items without compromising on quality. Given the ongoing polarisation of demand across value segments, it will also make sense for premium

players to consider whether they have enough brand equity to position themselves at higher price points. Across categories, however, the underlying principle remains the same in the challenging environment of diminished demand: winning brands will need to act quickly on changes in consumer behaviour while staying true to their brand identity.

Exhibit 4:

Fashion sales in China are expected to recover in 2020, while recovery in the US and Europe lags

FASHION SALES IN THE EARLIER RECOVERY SCENARIO, COMPARED TO 2019, %



Note: Scenarios intended to provide insight based on currently available information for consideration and not specific advice

SOURCE: MCKINSEY FASHION SCENARIOS





DIOR



1 HOUR PARKING
8 AM to 9 PM
MON - SAT
12 PM to 6 PM
SUNDAY

Covid-19 and the New Era of Luxury

A potent combination of long-term industry forces and pandemic-induced shocks have forced changes the industry had been anticipating for some time. How will luxury catch up now that years' worth of transformation happened in a matter of months?

by Lauren Sherman

Key Insights

- The pandemic has forced a shift away from buying experiences to buying things, but brands should prepare for the return of the experience economy.
- High-end watches and hard luxury are a strong category in the crisis market environment, thanks to their appeal as investment pieces.
- The luxury sector is poised for consolidation led by the biggest players, but the pandemic has shown that there is still room for smart young independent brands.

At the beginning of 2020, the luxury industry was at the precipice of a seismic shift. Consumers were increasingly choosing experiences over things, facilitating the rise of the resale and rental markets, and inspiring luxury brands to move further into hospitality. China, which accounted for the lion's share of growth in the market for personal luxury goods in 2019, had never been more important to the survival of old brands, and the development of new ones. E-commerce was steadily gaining market share and, while tourism remained a significant revenue-driver for luxury brands, growing government regulation was already making local customers more important.

Then the pandemic hit, and "seismic" took on a whole new meaning. The global Covid-19 crisis limited the mobility of even the wealthiest consumers because of lockdowns and other travel restrictions. In the 2019 fiscal year, EBITA (or earnings before interest, tax and amortisation) was down an average 3.2 percent, according to the

McKinsey Global Fashion Index. Economic profit, which factors in both explicit and implicit costs, was up by 4 percent. Companies big and small, successful and struggling, streamlined operations in order to account for the sudden dip in sales.

But it's not as if shopping halted altogether. Consumers, stuck at home worrying about their finances, were making buying decisions that would have been almost impossible to predict a year earlier. Years of online innovation and change happened in a matter of months, as brands focused on generating revenue from the only channel available in many markets: e-commerce.

Brands were motivated to do whatever they could to recapture lost revenue online. Still, even the biggest companies in the most profitable market segments have been hit hard. The luxury and affordable luxury segments have proven marginally more resilient, with sales shrinking an average 30 percent and EBITA an average 20 percentage points during the quarters falling between February and

June 2020, compared to the same period in 2019, according to McKinsey. Sales of mid-priced fashion brands were down 35 percent, with EBITA down 21 percentage points in the same period, while discount players experienced a 36 percent decline in sales, struggling under mountains of unsold inventory.

Years of online innovation and change happened in a matter of months, as brands focused on generating revenue from the only channel available in many markets: e-commerce.

As executives look ahead to 2021 and beyond, it is important to consider the longer-term ramifications for everything that has already happened — and the further changes to come.

The Enduring, All-Important China Factor

Companies that already had a major foothold in China, including luxury's power player conglomerates LVMH and Kering, got a head start in mitigating the pandemic, as the economic impact of lockdowns there were mild in comparison to that of the west — and mass testing made it easier to track and trace the spread of the virus. Brands that generate more than 30 percent of annual sales in the Asia-Pacific (APAC) region — including Mainland China, Japan, South Korea and Taiwan — achieved higher market valuations during the pandemic than their counterparts who did not have a strong presence in the region, according to analysis by McKinsey of 311 fashion companies that disclose regional sales figures. On average, APAC-focused companies boasted a market cap that was 18 percent higher.⁴⁴

Luxury brands have long relied on Chinese consumers to spend money abroad. But in recent years, as government officials put more restrictions on *daigou* sellers of grey-market goods and brands worked to harmonise their prices globally, it has

become more important to win the local customer by offering site-specific exclusives and entry-price products that appeal to the country's still-rapidly growing middle class. Even as consumers begin travelling again when the pandemic is behind us, the local customer will remain front of mind.

"Recovery is going to happen where businesses and retailers are not heavily tourist-dependent," said Robert Burke, a New York-based retail consultant who works with clients across the globe, from China to South America to Europe. "That's where we are seeing some of the best recoveries: where it's a local shopper."

Looking ahead, that means cultivating local shoppers in other regions too, like Europe, which is over-stored and heavily reliant on out-of-the-country visitors to drive sales. While local China customers will keep that market humming, brands must also look to cultivate local relationships in regions that have recently been more reliant on tourism to drive growth. "China is best placed, but one region can't carry an entire industry," said Philip Guarino, a Paris-based luxury advisor.

"Recovery is going to happen where businesses and retailers are not heavily tourist-dependent. That's where we are seeing some of the best recoveries: where it's a local shopper."

The coming years will also force brands to recalibrate their strategies in hard-hit regions like Brazil and India — and further ahead, make inroads on the African continent — where there are growing customer bases but also more barriers to entry and success. "The industry has an opportunity to reset its 'rest of the world' strategy," said Nelli Kim, a New York-based advisor to luxury brands and retailers. "So many people rely on China as the growth engine, [but] there are other emerging markets that also need attention."

IN-DEPTH

From Experiences to Things, and Back Again

For decades, a luxury handbag was the ultimate status symbol, especially for the newly wealthy. But pre-pandemic, it was already becoming clear that customers were looking for something more experiential. That's why luxury companies were hyper-focused on creating experiences, from Louis Vuitton's pop-up in Chicago's West Loop to coincide with Virgil Abloh's exhibit at the city's Museum of Contemporary Art, to the influx of hotel residences emblazoned with names including Versace, Armani and Bulgari.

“The industry has an opportunity to reset its ‘rest of the world’ strategy. So many people rely on China as the growth engine, but there are other emerging markets that also need attention.”

In 2019, market research firm Greenlight Insights projected that the global market for location-based entertainment would grow to \$12 billion by 2023, at a compound annual growth rate of 32.2 percent. As consumers made it clear that they were prioritising experiences over things, new business models emerged to ensure they would keep buying clothes in one way or another — from rental to online. But when the pandemic hit, travelling, visiting stores and even going out to eat became impossible for almost everyone. So, curiously, people started buying things again. Luxury handbags, shoes and jewellery fared better than expected in many cases, even if overall consumption was down on pre-pandemic levels.

By the third quarter of the 2020 fiscal year, certain areas of luxury were bouncing back. At LVMH, the fashion division — which includes the crucial leather goods category — was up 12 percent year-on-year, even as overall sales decreased 7 percent (attributed to challenges in its duty-free business), as well as at Sephora, its global beauty store. At independent brand Hermès, sales were

up 7 percent overall, with leather goods, apparel, watches, jewellery and home goods all returning to growth. At Kering, overall sales fell just over 1 percent, beating analysts' estimates by nearly 8 percentage points. While sales at Gucci fell almost 9 percent, hot label Bottega Veneta jumped 21 percent.

Has the culture regressed back to 2008, when “it bags” were *en vogue*? Probably not. It's unlikely consumers will continue to prioritise “things” longer-term after the pandemic. Business travel may not bounce back as quickly, but tourism and experiences are poised to rise in popularity once there's a proven vaccine. Brands must be prepared for another sudden shift back to pre-pandemic consumer trends. Resale has continued to flourish during the pandemic, rental will likely experience a comeback too.



A Bottega Veneta bag and shoes, Hamburg, Germany. Jeremy Moeller/Getty Images

Balancing Casual Luxury and Investment Pieces

Sales of activewear and loungewear — anything with an elastic waist — have soared through the pandemic, as consumers prioritise comfort, work from home, and adopt new exercise routines in the hopes of remaining active, even in

lockdown. While clothing and footwear brands suffered the biggest decline in value — their average market cap was down 18 percent and 19 percent respectively in October 2020 from December 2019 — the sportswear segment saw a strong recovery and increased by 7 percent.

But while the global casualisation of the wardrobe continues — even in China and other parts of the APAC region, where suiting has remained a typical work uniform for both men and women — it won't be the end-all. "Men have felt the need to change up their wardrobes," Burke said. "It's about casual, not athleisure."

In fact, most experts believe that the men's high end ready-to-wear market will continue to expand, whatever the future business-casual wardrobe looks like. "There is more innovation there," Kim said, noting the launch of the Air Jordan Dior collaboration as an exciting fashion moment that was also genderless in its appeal.

Most experts believe that the men's ready-to-wear market will continue to expand, whatever the future business-casual wardrobe looks like.

"The young people are shopping — and a lot of young men," added Sharifa Murdock, co-owner of Liberty Fashion & Lifestyle Fairs, which includes Capsule. "They're shaping the culture."

But not every category is winning with these important cohorts. "Watches under 1,000 Swiss francs [approximately US \$1,090] are doomed," said Elsa Berry, founder of luxury M&A advisory firm Vendôme Global Partners, referencing the lower end of the market's growing irrelevancy in the face of digitisation.

"High-end watches and solid luxury jewellery, however, are remarkable in several aspects." Not only are one-off watches and fine jewellery considered investment pieces, they are all also benefiting from the general trend in self-gifting, including a "serious level of interest" in the

Chinese market. "The Chinese consumer used to buy jewellery for the weight of gold; now they're buying it because it's beautiful. It's a wonderful way to show their personality, their taste level and to discreetly stand out."

Chinese group Fosun acquired a majority stake in French jewellery brand Djula in late March 2020 through its Yuyan subsidiary in the midst of the pandemic, which she said is evidence that there is market confidence in the category's growth potential.

Personalising Retail Everywhere

In 2019, e-commerce made up between 10 and 15 percent of global luxury sales, with Europe and China at the lower end of the range and the US at the higher end. By 2020, the figure had risen by at least 50 percent across all three regions, according to McKinsey. At online luxury marketplace Farfetch, second-quarter sales were up nearly 75 percent from a year earlier to \$365 million. Gross merchandise value — or the cost value of goods sold on the site — was up 48 percent. By October, the average market capitalisation of internet retailers was up 42 percent from December 2019.⁴⁵

Single brand retailers from Nike to Louis Vuitton also saw an uptick online, which they attributed in part to personalising the shopping experience in every channel.

In the past, the "one to one" experience, as Nike calls it, has been reserved for only the top tier of customers. Now fashion brands must make every customer's experience feel more unique through a mix of artificial intelligence, human recommendations and direct contact with salespeople using client communication apps and customer relationship management tools. This won't be easy to scale, as it requires a mix of sophisticated technology and a savvy, well-educated salesperson. "It'll be interesting to watch how they do it — and if they can do it," Kim said.

One outcome may be fewer, larger transactions. "So many consumers have shifted to digital that an older demographic is now converting," said Adam Freede, chief executive of US-based

IN-DEPTH

Madaluxe, a third-party distributor for fashion brands. “Customer acquisition costs per order have come down.”

Whatever happens, the physical retail store will be as important as ever — even if there are fewer of them overall. “Stores are really going to have a heyday,” Berry said. “[Changed consumer behaviour] is going to put pressure on the stores that do exist to be super interesting.”

Big Guns and Creative Independents

The luxury industry was already busy consolidating long before the pandemic, as giants squeezed out mid-sized brands unable to compete with the scale of strategic conglomerates. While each brand in a conglomerate’s portfolio commonly pursues independent strategies, synergies at the group level mean brands still benefit in just about every area across talent acquisition, marketing spend, retail footprint and supply chain. Those best positioned to prosper in the next phase of industry growth are conglomerates like LVMH and Kering and vertically integrated independents like Chanel and Hermès, companies that have the ability to directly manage inventory and can easily stop and start production.

“If you don’t have your supply chain, e-commerce, etc. up and running in all markets, then you’re a weakened player,” said Anne Line Hansen, founder of AH Advisory, a boutique European consulting firm. “Without the infrastructure, mid-sized brands are better off being consumed by a group.”

However, Berry believes there may be an opportunity now for mid-sized brands to come together and form new entities that are better positioned to go up against the giants. “The world has become very complicated... but [conglomerates] are going to get too big,” she said. “There is going to be some consolidation between mid-sized companies that are more family- and culture-driven and less corporate.”

And yet, industry consolidation does not mean upstarts will be edged out completely. During the pandemic, many young, independent brands

have actually thrived. Some because they operate on such a lean budget — using the pre-order drop model to drive sales — and weren’t weighed down by excess from the spring season. Others managed to gain mindshare because they have been nimble enough to react rapidly to changing customer sentiments — either by creating relevant products or responding to cultural movements in a sensitive, authentic way.

“If you don’t have your supply chain, e-commerce, etc. up and running in all markets, then you’re a weakened player. Without the infrastructure, mid-sized brands are better off being consumed by a group.”

While the conglomerates are certainly safer than most, a crop of independent brands in the accessible luxury space, including Brooklyn-based Telfar, Los Angeles fashion collective Brain Dead and sweatpants connoisseur Entireworld, made waves and sold out product, proving that there is still room for smart, original ideas that appeal to the next generation of luxury consumers, who are more attuned to false marketing. The luxury customer of 2020 is well-educated about the product and has high expectations, and they’re only going to become more knowledgeable in the years to come.

“Niche brands are willing to test and listen to what their consumers want,” Hansen said. “It has forced everyone to be more creative.”

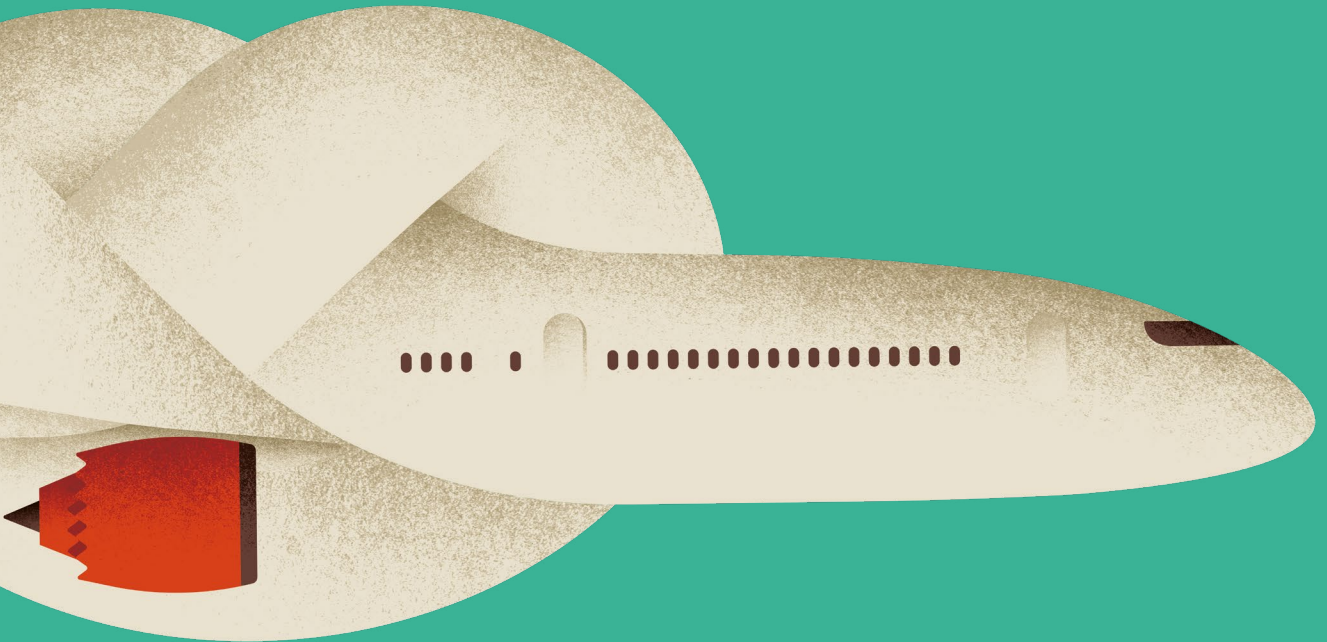
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A paper airplane with a red stripe on its wing, flying towards the right. It is made of light brown paper with visible texture and has small black dots representing windows.

03. DIGITAL SPRINT

04. SEEKING JUSTICE

05. TRAVEL INTERRUPTED



03. DIGITAL SPRINT

Digital adoption has soared during the pandemic, with many brands finally going online and enthusiasts embracing digital innovations like livestreaming, customer service video chat and social shopping. As online penetration accelerates and shoppers demand ever-more sophisticated digital interactions, fashion players must optimise the online experience and channel mix while finding persuasive ways to integrate the human touch.

With the global pandemic keeping people at home, 2020 may be remembered as the year in which fashion retail made a definitive shift online. Over a period of just eight months, e-commerce's share of fashion sales nearly doubled from 16 percent to 29 percent globally, jumping forward six years' worth of growth.⁴⁶ There are of course clear winners from this behavioural shift, with online marketplaces faring especially well. Zalando saw new customers rise by 39 percent year-on-year in April⁴⁷ and Farfetch posted a 74 percent uplift in revenue in the second quarter, compared with the same period the previous year.⁴⁸ Meanwhile, digital traffic to the websites of the top 100 European brands surged by 45 percent in April, compared with March.⁴⁹

The relative strength of digital channels was reflected in stock market performance too. While the fashion industry as a whole saw net declines in valuations, digital players were more resilient than their physical peers. From January to October, internet retailers had on average 42 percent higher valuations than other listed fashion companies, when indexing stock prices to December 2019.⁵⁰ Adobe Analytics analysis of fashion e-commerce site visits shows the widening gap between the best and the rest. While overall US and EMEA digital revenues grew 24 percent year-on-year in the period of January to September 2020, the top 5 percent grew revenues 220

percent, while the bottom 25 percent declined by 2 percent.⁵¹

Over the next year, momentum in e-commerce will only accelerate. Fashion executives see digital as the biggest opportunity by far for 2021, with 70 percent of executives expecting growth of more than 20 percent in their e-commerce channels.⁵² The trend will be led by China, followed by Europe and then the US — markets in which online sales are expected to grow 9-14 percent, 7-12 percent and approximately 3 percent respectively according to McKinsey Fashion Scenarios (based on information available September 2020).⁵³

The dynamic e-commerce landscape in Southeast Asia is also expected to present fashion players with new opportunities. "We have been witnessing a profound structural shift to digitalisation across our market," said Forrest Li, the chief executive and co-founder of Sea Limited, during an earnings call in August 2020.⁵⁴ Sea Limited owns Shopee, an online shopping platform, which has localised sites for Singapore, Indonesia, Vietnam, Thailand, Malaysia and the Philippines.

As online channels continue to prosper, it is likely that physical retail's struggles will persist, and we expect to see fashion companies continuing to close stores in 2021. One example among many so far was Inditex's announcement that it would close up to

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1,200 stores worldwide and focus on digital growth.⁵⁵ Diane von Furstenberg said it would close all of its stores and move to a digital-only model.⁵⁶

“Retail isn’t dead, but boring retail is dead,” said Rania Masri, chief transformation officer of Chalhoub Group, a Dubai-based retail and distribution company that partners with global luxury brands across the Middle East.⁵⁷ “It’s always multi-layered, it’s not just about tech, it’s also about the people and how they work together in order to change and develop the experience we want to offer.”

To maximise impact amid a rapidly changing channel mix, fashion players must find new ways to excite customers and encourage them to engage online. History shows us that, in a disrupted macro environment characterised by shifts in consumer behaviour, excellent customer experience yields financial results as well as opportunities for companies to recalibrate their propositions. Following the 2008 global financial crisis, customer experience leaders posted three times higher shareholder returns than laggards.⁵⁸ This is an important point for brand executives to appreciate because there is a new picture emerging around brand loyalty. During the coronavirus pandemic, consumers across countries have indicated they are willing to move away from their favourite brands and to experiment more. In fact, over 60 percent said they switched brands or retailers in the early part of the year.⁵⁹

In China, innovations such as livestream commerce have captured the imagination and helped to bridge the gap between physical and digital by bringing human interaction to the digital shopping experience. The trend started as early as 2016 with the launch of Alibaba’s Taobao Live. Three years later, Chinese livestream revenues amounted to \$63 billion. They are set to rise to \$138 billion in 2020, according to Coresight and iResearch,⁶⁰ having been boosted significantly by lockdowns. The number of sellers on Taobao Live grew by 719 percent in February alone.⁶¹ Influencers have also proven their value in the livestreaming environment, in some cases generating more sales in a few hours than department stores do in a day.⁶²

“Customers are craving newness, and livestreaming is a safe and exciting way for us to

deliver exactly that, especially at a time where some customers are not able to join us in stores,” Josie Zhang, president of Burberry China, explained in her introduction to Burberry’s Tmall livestream session in March 2020, which garnered 1.4 million views and resulted in many of the featured products selling out within an hour.⁶³

With so much buzz around the channel in China, it is little wonder that global brands, including Ralph Lauren, Levi’s and Burberry, have begun to experiment with it.⁶⁴ However, luxury players are discovering that it is challenging to maintain a gilded and distinguished brand positioning while creating the kind of natural, chummy atmosphere that the medium requires. Nonetheless, we expect many fashion brands to continue to trial and refine livestream strategies for China in the year ahead.

Despite its early hiccups, Livestream is starting to gain traction outside of China, with US livestreaming revenues expected to hit \$25 billion by 2023.⁶⁵ Livestream commerce is also likely to accelerate in 2021 as big tech firms and social media innovations enable direct online checkouts. Instagram introduced in-app checkout for Instagram Live in August 2020⁶⁶ and TikTok hosted its first shoppable livestream in the same month.⁶⁷

Other new digital opportunities are leading to creative solutions for marketing, design and new revenue streams across the fashion industry. A partnership between Ralph Lauren and Snap Inc., for example, will create virtual branded apparel for avatars,⁶⁸ while other collaborations exist between fashion companies and video games. A deal between Louis Vuitton and the League of Legends introduced in-game skins designed by Creative Director Nicolas Ghesquière to accompany a real-world capsule collection, and Net-a-Porter in China launched Animal Crossing skins showcasing Spring/Summer collections of local brands, connected by QR codes linking to products on the e-tailer’s Tmall store.⁶⁹ With no end in sight for the trend towards increased screen time and digital interaction, virtual fashion is likely to emerge as a not insignificant opportunity for brands both as a revenue stream and as a channel for product discovery.

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In other emerging digital trends, messaging apps leveraging remote clienteling are proving their value in supporting consumer purchasing decisions. From Japan's Line to Russia's Telegram, the apps provide marketing, customer service and social commerce opportunities, tapping hundreds of millions of users. At the height of the pandemic, Chinese retailers capitalised on people's desire for human interaction by publishing QR codes to link consumers with sales reps in hundreds of brand-based WeChat groups.⁷⁰ In Brazil and other Latin American markets where WhatsApp is popular, offline retailers leveraged the app for remote shopping.

Where it is not possible to integrate human interaction into the digital experience, artificial intelligence (AI) is likely to play an increasingly prominent role in boosting conversion, giving customers the chance to experiment with virtual try-ons powered by augmented reality. Several brands are now using these formats, including some formerly digital-resistant luxury watch players such as Grand Seiko.⁷¹ The growing appetite for AI makes a lot of sense. Shopify found that conversion rates increased 250 percent for products that were supported by try-on technology.⁷²

To support the digital customer journey, many fashion companies are now investing to elevate

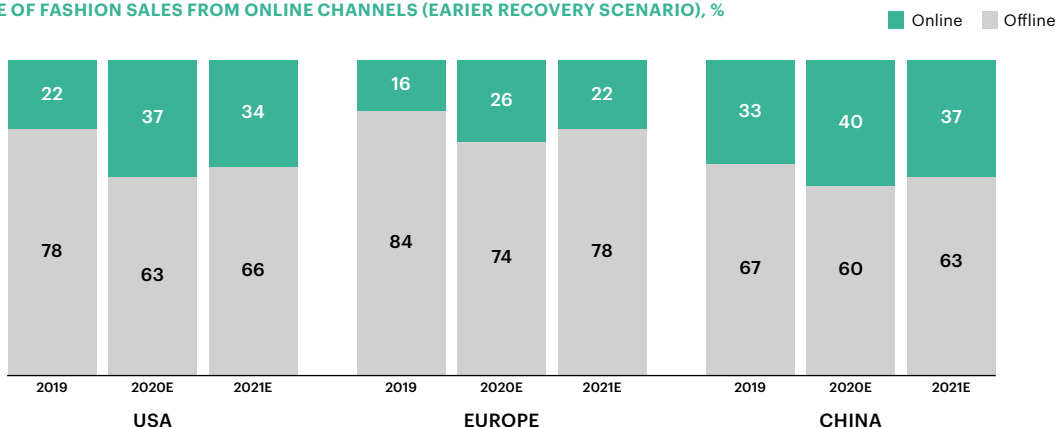
omnichannel ecosystems across platforms. As retailer app downloads surge, brands are building next-generation apps featuring storytelling and elements that connect digital experiences to physical stores, such as in-store self-checkout. At Burberry's "social retail store" in Shenzhen, China, omnichannel has been woven into the shopping experience; customers are rewarded with social currency for online and offline engagement on the brand's WeChat's mini-program — exchangeable for free menu items at the in-store café.⁷³

In the coming year, we expect brands to elevate the online customer experience even further, as digital is augmented with physical, and vice versa, in increasingly sophisticated ways. To power up e-commerce growth, the digital customer experience and behavioural insights will be the top two priorities for data and analytics in 2021, according to fashion executives.⁷⁴ In addition, brands will leverage innovations including integration of social shopping, reviews, gamification and personalisation, aiming to create a richer digital experience. One departure from the past, however, is that fashion players will need to be much shrewder with their investments to focus on those innovations that deliver on the bottom line.

Exhibit 5:

The share of online fashion sales is expected to remain high in 2021

SHARE OF FASHION SALES FROM ONLINE CHANNELS (EARIER RECOVERY SCENARIO), %



Note: Scenarios intended to provide insight based on currently available information for consideration and not specific advice

SOURCE: MCKINSEY ANALYSIS; EXPERT INTERVIEWS; EUROMONITOR INTERNATIONAL LIMITED, APPAREL 2020 EDITION AND LUXURY GOODS 2019 EDITION, SHARE OF E-COMMERCE SALES (FOR 2019)

Kering: Fast-Tracking a Digital Upgrade



Grégory Boutté
Chief Client and Digital Officer, Kering

The man tasked with leveraging digital to create an integrated customer experience at the group behind Gucci, Saint Laurent and Bottega Veneta says that it's 'full-steam ahead' for e-commerce growth in 2021. The challenge will be to reinvent Kering's sprawling store network for ultra-connected luxury consumers on multiple platforms.

— by Robert Williams

The primacy of digital has been a long time coming for luxury, but even as discovery shifted to platforms like Instagram and WeChat, the sector was slow to embrace online retail. When stores shuttered during the first half of 2020, however, the critical importance of e-commerce became immediately apparent. Kering, for one, saw its share of online revenues more than double.

Momentum in e-commerce channels will continue to grow in 2021, but with long-haul tourism still frozen and store traffic struggling to rebound, the French luxury giant's chief client and digital officer faces a challenging environment for omnichannel in the year ahead. Not only does Grégory Boutté have to find a way to make Gucci's network of nearly 500 stores relevant in an overwhelmingly digital world, he also has to fast-track an e-commerce overhaul at Kering's other billion-dollar-plus brands like Saint Laurent and Bottega Veneta.

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You're Kering's chief client and digital officer. Can you tell us a bit more about the connection there?

I think François-Henri [Pinault]'s vision in creating this role was that digital is the means to an end. My job is about starting from the clients, leveraging digital to create the best experience for them.

For all Kering brands except Gucci — including Saint Laurent, Balenciaga, Bottega Veneta and Alexander McQueen — Yoox Net-a-Porter had been operating their e-commerce businesses via a joint venture until this year, when you were set to move those functions in-house. Why?

If a quarter of our business and so many of our interactions with clients are going to happen online, we want to control that experience. We think our clients want to move seamlessly between the different channels: making it so if you buy online you can pick up in store, you can book an appointment in-store online, you can reserve a product to try on, you can buy online then return it in-store. The only way to build those bridges is if you control both sides of the equation.

Those sort of click-and-collect services and in-store appointments are no doubt more important since the pandemic, even if we'd already been hearing a lot about this "omnichannel" approach in recent years. Are there any other ways you plan to blend online and offline services for the next phase?

One area where we accelerated some efforts on omnichannel is distance sales, making it so a client visiting our e-commerce site can

actually interact with sales associates in the store. So, if a customer says yes to using the feature, a sales associate in the store could chat with the customer, or even do a video and have them show some particular products and even close a sale. We've piloted that in some regions with a programme called Gucci Live and we're getting an amazing response from our clients, both in terms of qualitative feedback and conversion.

Before the pandemic, McKinsey had forecast that e-commerce would account for around 20 percent of overall luxury sales by 2025. Kering exceeded that forecast in some regions this year, five years earlier than expected. After such a rapid surge, will online sales channels still grow next year?

"If I had one [piece of] advice for a small brand that's not part of a group like ours, it would be to really pick their battles. My advice would be do a few things extremely well, and delight a niche of customers."

Our e-commerce revenue during the first half of 2020 went from 6 percent to 13 percent of overall retail revenues year-over-year. In North America we were as high as 26 percent e-commerce — so already ahead of the 20 percent McKinsey expected for 2025. I expect e-commerce to continue to accelerate in the coming years, because this is addressing a fundamental trend in our business. We're seeing a lot of the luxury growth coming from younger generations as well as Chinese customers aspiring to buy our products, and the common theme

between those two populations is that they're ultra-connected. Of course, in terms of the share of e-commerce it will normalise a bit, since a lot of [what] we saw in the first half of the year has been driven by our retail network being closed. But I think it will be at a much higher level than expected prior to the pandemic.

One trend we've been seeing in the digital space in recent years has been faster growth for big brands while smaller brands underperform. What's driving that polarisation online? Do you think that gap will continue to widen next year?

That's not just online; it's a generalised phenomenon that digital is a part of. Building a luxurious experience online and building a digital footprint is very hard to do

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Without that kind of group investment, how can a small, or a medium-sized brand be the exception, and really win some visibility online?

If I had one [piece of] advice for a small brand that's not part of a group like ours, it would be to really pick their battles. When you look at a brand like Gucci which is going after every opportunity in the digital space, it's very tempting to try to go after all of those opportunities too. My advice would be to do a few things extremely well, and delight a niche of customers. Trying to do everything could result in being average, and not cutting through the noise.

We've heard so much in recent years about the importance of e-commerce for Chinese luxury consumers, especially those who buy through very advanced digital channels in China's own distinctive online environment. What are Kering brands doing to scale up activity in this space?

E-commerce is huge in Asia, but when you look at luxury, it's still very nascent. That's something that not everybody understands. The ecosystems are incredibly different from what we are used to here, as ".cn" e-commerce sites are less popular in China than [their ".com" counterparts] in Europe and the US, and there are some very specific players you have to work with. [But] Gucci has launched its [Chinese] site and we're seeing tremendous traction there, and we are also building our presence in [the country's] very specific ecosystem. We've opened flagship stores for some of our brands on [Tmall's] Luxury Pavilion and we're also opening WeChat stores. This is an extremely fast-moving market

where we see new platforms and new usage happening all the time.

Could this diversity of approaches — being available to buy on WeChat, Tmall, or even livestream channels your brands have experimented with — open up luxury brands to a greater risk of counterfeiting? I would have thought you'd prefer to train customers to know there's only one or two places to buy genuine Gucci or Saint Laurent, for example?

This allows us to have better control rather than creating more risk. Our clients are incredibly savvy and they understand where they can find genuine products. They understand which channels are controlled by the brands they aspire to engage with and it makes the other channels look not as attractive. When we build our presence in a way that's relevant for our brands in those parts of the ecosystem, I think we're adding trust.

What sort of tech should we expect to see more of in your brick-and-mortar stores? There have been a lot of "store of the future" innovations touted in recent years, and I'd be curious to know which ones you see actually taking off?

We've not made huge investments in IT like connected mirrors, but rather focused on tools that aren't visible to our clients, which augment the performance of our sales associates. We want to leverage that human contact as opposed to digital for the sake of digital. We have an app we've developed in partnership with Apple, which allows the store associates to check stocks in real time so they don't have to leave

the clients. For clients who accept to be identified, the sales associates can also access their purchase history and recommend products and sizes based on past purchases.

You also have clienteling, managing contact details in the app so that the sales associates can reach out at a distance. This has proven to be absolutely critical in the context of the pandemic. During the lockdown with the retail stores being closed, sales associates could stay in touch with clients and do distance sales. Then as stores reopened, they could prepare appointments and reach out to customers in a personalised way.

We've also been hearing more about zero-inventory concepts this year as brands are trying hard to not hold stock. Some designers are even experimenting with a pre-order model. Are those ideas relevant for Kering's brands in the luxury sector, perhaps as a return to the old model of couture?

We've been rolling out algorithms that use AI to forecast sales for new products. What we've built so far is 20 percent more accurate than what we had been doing [before]. Zero stock is definitely something we aspire to, but it's further down the road since we're still in the early days of being able to predict exactly how our products are going to sell. We do use pre-orders sometimes, but we're not going to switch to a model where we would produce on-demand for customers. Part of the magic of the in-store experience is being able to try a product in the store and then have it immediately. We want to keep that.

This interview has been edited and condensed.

Alibaba: Innovating for China's Advanced Ecosystem



Mike Hu

Alibaba Group Vice President and General Manager of Tmall Luxury, Fashion and FMCG

The luxury sector's reliance on the Chinese market has been further amplified by a slow recovery from Covid-19 in the west. Mike Hu, the executive who manages relationships with luxury brands like Burberry, Versace and Cartier for Alibaba-owned Tmall, says that the e-commerce giant will employ a new 'three-dimensional model' of retail to meet its 2021 targets.

— by Casey Hall and Zoe Suen

China was the first major global economy to return to substantial growth following a record contraction in 2020. Malls have since reopened in cities from Beijing to Wuhan and — with global travel at a standstill — home-bound luxury shoppers have been spending more than ever in the mainland. A lot of this activity is online, much to the benefit of major players like Alibaba-owned Tmall, which unveiled a new outlet channel Luxury Soho to complement Luxury Pavilion, its core sub-platform that works with almost 200 luxury and designer brand partners.

Though the rivalry between Tmall and JD.com continues to dominate China's fashion e-commerce market, both face growing competition from smaller

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upstarts. But Mike Hu is not worried. The executive in charge of luxury, fashion and FMCG at Tmall says the firm's wealth of consumer data and suite of tailored tech innovations like livestreaming will keep it on track to meet some of its lofty targets next year.

During the widespread outbreak in the mainland in January 2020, there must have been a lot of uncertainty within Alibaba Group — as with all Chinese companies — about business prospects for 2020. But we've since witnessed China's strong economic rebound from Covid-19. How do you assess Tmall's recovery since then?

Since the pandemic we've seen some very obvious phenomena. The first is that because a lot of people can't leave the country, they're shopping more domestically. As early as July, online sales of luxury products were already back to pre-pandemic levels. Second, we've seen luxury brands accelerate their digital transformations. For example, an increasing number of brands have chosen to open flagship stores on Tmall. More and more brands are now positioning Tmall as their second official website [in China]. Third, we've seen more brands start to use Tmall to reach consumers from lower-tier cities. Brands may slow down their expansion of physical stores offline, given the uncertainty of the pandemic, but they can leverage Tmall to approach consumers in [cities that are not first- or second-tier].

We've been hearing about the growth of China's lower-tier city consumption power

for quite some time. How significant will this be next year for online channels in the post-pandemic market environment in categories such as luxury, for example?

Luxury brands are especially interested in discussing with us about how and whether Tmall can reach fourth- and fifth-tier cities now. We think livestreaming is very important in this regard. Currently, around 60 percent of our livestreaming audience is from lower-tier cities.

“Over the next two years we hope to increase the number of luxury brand flagship stores on Tmall by more than 100 percent annually.”

Tmall has spent many years courting international brands. Now that we are living with the virus and the global economic reality it has created, do you see any remaining hesitation on the part of luxury brands to embrace new digital innovations in China's unique ecosystem?

A more digital way of doing business is now essential for luxury brands, because at the heart of their business, they care about the experience of the customer. This is Alibaba's obvious strength. We research people's preferences and explore new styles and new brands for them. We're shifting to more of a customer to business (C2B) model; this is a huge

change. This means that we see [things through the lens of the] customer and we don't just focus on whether he or she buys something. We closely observe their behaviours, interests, likes, scrolling, attention, interest, purchasing and loyalty — we can see all sides clearly. In China, we call this strategy *gong zhen* (strategic resonance); brands and Tmall move in tandem in order to develop a common language and find the right way forward in the market.

The outlook for global luxury consumption remains uncertain, meaning major high-end brands will be relying on Chinese sales more than ever. What are your expectations and plans for Tmall's fashion, beauty and luxury categories over the next year?

Over the next two years we hope to increase the number of luxury brand flagship stores on Tmall by more than 100 percent annually. This is a goal we believe will be easy to achieve given the current trajectory. First, we want to cultivate consumers' online shopping habits. After all, offline shops have limitations. This new generation is the Wi-Fi generation so [we need to ask ourselves], “How do we use Tmall to give them new products and more specialised products?” Additionally, we are in an age of content. How do we use short videos and livestreaming to help luxury brands reach more users? Over the next few years, we need to engage in deeper discussions with the big groups — LVMH, Kering and Richemont — about our three-dimensional model of online and [physical] retail. We are not only focused on digital

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growth: we would also like to make offline stores a more interactive, elevated experience. This would involve cooperating on many fronts, from content to social media to B2C to supply chains and consumer behaviour.

What about smaller brands?

We hope to add more niche brands to our platform — labels that may be well-known in their home markets and have a long history but remain unknown to Chinese consumers. Take the Italian luxury brand GCDS, which launched its Tmall store in August. Also, how should brands with 50 years of history but that are new to our market engage with Chinese shoppers? We're trying to find ways to accelerate their journey and find success here.

Covid-19 has fundamentally changed the way people shop on a global level. Can the same be said of Chinese shopping habits and the way consumers engage with online marketplaces, such as Tmall? How will the pandemic impact future consumption trends in China?

The pandemic has had a limited impact on high-net-worth individuals as they have a higher risk tolerance. Younger consumers and especially those from lower-tier cities, however, have been affected. In the future, I believe consumers will be more cautious in their spending and show more interest in low-cost products. In other words, the wallet share of consumers from lower-tier cities will [eventually] decrease. Meanwhile, we are also seeing an increase in consumption for household goods. Short-distance travel has also gained in popu-

larity. Given this, we are putting emphasis on domestic consumption scenarios and are paying attention to categories that have the potential to sell well.

“We are not only focused on digital growth: we would also like to make offline stores a more interactive, elevated experience.”

Brands will continue to jostle for Chinese customer engagement in an increasingly crowded market. How can Tmall help brands reach Chinese consumers in new ways in 2021?

Every year we develop a joint business development plan with these groups and develop projects, products and solutions for their needs. Estée Lauder [Companies], for example, has been with us for four or five years exclusively — they don't want to sell through too many channels as this makes it hard to control pricing and promotions. Burberry and Cartier follow the same exclusive partnership model. We have a whole package that helps brands target commodity management, memberships and [related] services. Different brands have different sales models and therefore require different solutions.

What will be the next big technological advance that Tmall focuses on? Will the livestreaming boom of this year carry on in 2021?

We're really confident about the prospects of livestreaming, particularly as an interactive tool for young consumers. But its characteristics will change. There will be a greater diversity of broadcasters. Today, it's mostly KOLs [influencers known

locally as Key Opinion Leaders], celebrities and sometimes executives of companies that use livestreaming to sell products — this mix is likely to broaden

in the future. During this year's 6.18 Mid-Year Shopping Festival, around 40 percent of livestreams were hosted by big brands. This percentage is expected to grow to 70 to 80 percent during the upcoming 11.11 Shopping Festival. By next year's 6.18 Shopping Festival, we expect that even more brands will host their own livestreaming shows. Finally, we also see a new trend among luxury brands of using short videos to mix with livestreaming to further secure the quality of visual content while connecting with their consumers.

This interview has been edited and condensed.



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With garment workers, sales assistants and other lower-paid workers operating at the sharp end of the crisis, consumers have become more aware of the plight of vulnerable employees in the fashion value chain. As momentum for change builds alongside campaigns to end exploitation, consumers will expect companies to offer more dignity, security and justice to workers throughout the global industry.

Fashion's impact on the environment has been in the crosshairs of public perception for some years, as environmental activism increased in prominence and brands started to become more transparent about their practices. Now, social justice and human rights issues are gaining a higher share of voice in the conversation about the fashion industry's pressing need to improve its sustainability credentials. While it is yet to be seen whether consumer attitudes will translate into tangible changes in purchasing behaviour, it is certain that the pandemic has amplified public awareness of social injustice in the supply chain.

The pandemic has amplified public awareness of social injustice in the supply chain.

Indeed, as factories closed in early 2020, orders were cancelled and payments were deferred or renegotiated, the plight of the 40 to 60 million global garment workers impacted by the crisis became even more visible to consumers.⁷⁵ Suppliers across the world were reported to have lost over \$16 billion in revenues between April and June 2020.⁷⁶ In May, labour rights activist Kalpona Akter painted a stark picture of the plight of garment workers. "Everyone in the supply chain needs to

understand that all the... cancellations [and] not getting money is put on the workers' shoulders," said the founder and executive director of the Bangladesh Centre for Worker Solidarity, in an interview for The Business of Fashion Podcast.⁷⁷ "Why is it always us that has to suffer, even in this pandemic?"

There are signs that the fashion-buying public is taking action to demand better treatment of workers in the value chain. Thousands of consumers worldwide have participated in the #PayUp campaign, which calls out brands that have not committed to pay for in-production or completed orders during the Covid-19 crisis, which consequently puts millions of vulnerable workers at risk. As public concern and campaigns grow, a growing number of brands have started to look at more fundamental changes in their purchasing practices (see Deeper Partnerships on page 70).

But manufacturing is not the only area under scrutiny. The social justice spotlight has turned to all aspects of the fashion value chain, from the fields where textile fibres are grown to the stores that stock final products. When the Arcadia Group, whose high street brands include Topshop and Dorothy Perkins, attempted to award as little as 50 percent of notice pay to some head office staff facing redundancy, the combination of

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negative press, campaigner action and a union's threat to take legal action compelled the company to reverse the decision.⁷⁸ However, at the same time, there are many instances of accusations of poor worker treatment or unfair compensation at warehouses and logistics centres that persist without intervention.

Consumers are demanding more from brands in their engagement with socio-political values, too. Kantar Monitor research found that 54 percent of consumers believe brands “have an important role to play in social conversations about issues like #MeToo and race relations,”⁷⁹ but when brands fall short, consumers are quick to call them out. Brands that jumped on the Black Lives Matter movement with tokenistic marketing messages have faced accusations of hypocrisy, while many brands have been called out for having all-white upper management teams.

In the year ahead, the longer-term trend of citizen activism will continue, boosted by social media and a widening gap between the rich and poor exacerbated by the pandemic. Gen-Z, which will account for more than 40 percent of global consumers in 2020, will lead the charge as the most politically active age group on social platforms.⁸⁰ In the US, research by the Pew Research Center shows younger cohorts are most likely to encourage action online and to use hashtags relating to political or social issues.⁸¹

Consumers are demanding more from brands in their engagement with socio-political values.

Still, the overall picture remains complex. Often, the strongest critics of brands are not their biggest consumers, and infringements of social justice or human rights do not always translate to declining sales. UK-based Boohoo Group saw its share price dive in July 2020 amid allegations that its factory forced employees to work when sick, on a wage of as little as £3.50 (approximately \$4.50)

an hour.⁸² An independent review commissioned by the brand and carried out by Alison Levitt QC found that the allegations of “unacceptable working conditions... are not only well-founded, but are substantially true.”⁸³ In Boohoo's response to the review, Group CEO John Lyttle said that the company would need to “go further and faster” to improve its governance and compliance.⁸⁴ However, the company's sales still rose nearly 50 percent quarter-on-quarter and its share price recovered fairly quickly.^{85 86}

66 percent of consumers said they would stop or significantly reduce shopping at a brand if they found it was not treating its employees or suppliers' employees fairly.

Clearly, there is often a gap between consumer attitudes on social justice issues and their purchasing decisions. What is unclear, however, is how long the gap will last. In an August 2020 survey by McKinsey, 66 percent of consumers said they would stop or significantly reduce shopping at a brand if they found it was not treating its employees or suppliers' employees fairly.⁸⁷

Among marginalised communities, consumers increasingly expect fashion companies to put money behind their stated values when it comes to racial injustice. It is with this in mind that Aurora James, the founder of sustainable shoe and handbag brand Brother Vellies, launched the 15 Percent Pledge, a non-profit that campaigns for diversity in the fashion industry by challenging retailers to dedicate 15 percent of shelf space to Black-owned businesses.⁸⁸ “Historically, less than 1 percent of venture capital money has gone to Black individuals,” said James, in an October 2020 interview with BoF.⁸⁹ “It's not that Black people aren't already ideating on amazing products or creating them on their own, it's that they don't have the resources to package them and put them out in a

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way that's going to work for those resources.”

In many countries, heightened citizen awareness is helping to build momentum for new employment legislation, though it is important to note that labour laws have historically been poorly enforced. The European Commission, for example, has committed to setting rules for mandatory corporate environmental and human rights due diligence, which is in a discussion phase as of October 2020,⁹⁰ while in Germany there are plans to enforce protection of supply chain workers.⁹¹ Meanwhile, Middle Eastern states including Qatar and Lebanon are taking steps toward abolishing the punishing “kafala” (sponsorship) employment system for migrant workers.⁹² However, progress does not always follow an upwards trajectory — India cleared new labour codes in September 2020, raising concerns that workers could be fired by employers more easily,⁹³ and in California, a new bill to protect garment workers was deprioritised from discussion in the 2020 legislative session.⁹⁴

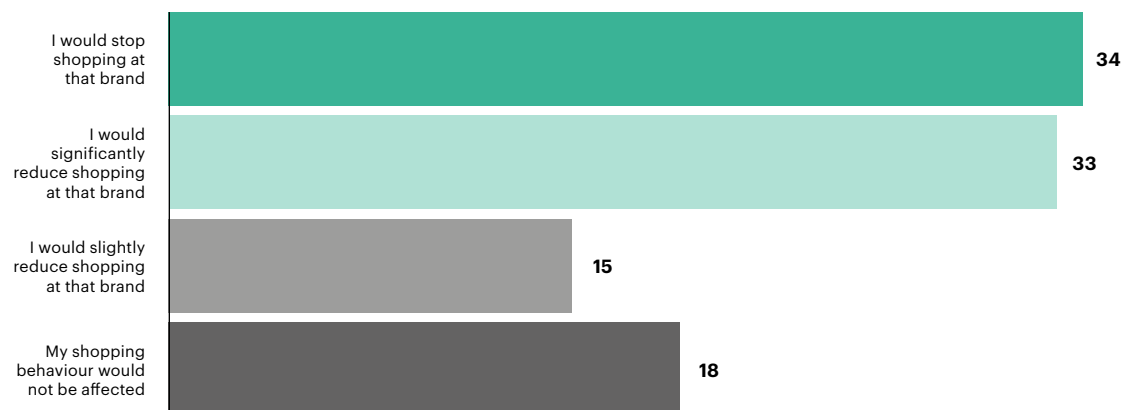
Now it is time for fashion companies to adhere to the highest standards of human rights and social justice issues across business operations. The key in these endeavours should be authenticity and action, which can be achieved through meaningful engagement with trade unions, direct worker engagement, non-profits and workers' rights watchdogs.

Companies should focus on transparency and concrete plans to support commitments as a first step. Introducing concrete changes to purchasing practices are crucial, such as ringfencing labour costs in negotiations as a way to pay workers in the supply chain a living wage. Finally, decision-makers expecting furloughs, layoffs or shifts to temporary contracts should prepare workers for any changes and resist the temptation to cut corners at a time in which employees — and their personal finances — are increasingly under strain.

Exhibit 6:

Two-thirds of consumers indicate they would stop or significantly reduce their spend with brands who mistreat their employees or suppliers

% OF RESPONDENTS



SOURCE: MCKINSEY FASHION SCENARIOS: CONSUMER SURVEY IN GERMANY, UK AND SPAIN, AUGUST 2020

Louis Vuitton: Hardwiring Accountability in a State of Flux



Michael Burke
Chief Executive, Louis Vuitton

Louis Vuitton — the largest luxury brand in the world by revenue before the Covid-19 crisis — was hit hard by the pandemic. But Chief Executive Michael Burke led the company to a healthy rebound by engaging local clients and driving sales online. Now, the seasoned executive is calling for a return to the original values of luxury, which he says are key to creating a more sustainable business model.

— *by Imran Amed*

Like all fashion companies dependent on a mostly physical retail model, Louis Vuitton was hit hard by the crisis. Profits at parent company LVMH plunged by 68 percent in the first half of 2020. But revenues bounced back in Q3 when sales in the fashion and leather goods group at LVMH were up 12 percent year-on-year, led by a strong performance at Vuitton, which succeeded in engaging local customers and driving sales online.

All the while, Vuitton was also working hard to polish off its sustainability credentials, communicating them openly in a dedicated new section of its consumer-facing website launched in September. The visible shift in strategy underscores the growing importance

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of transparency throughout the luxury supply chain. As he looks ahead to 2021, Chief Executive Michael Burke is more cognizant than ever of the responsibility Louis Vuitton bears to protect people and the planet — and that his customers will increasingly hold him to it.

What have you learned and taken away thus far from this crisis?

Who said this, was it Churchill? “Planning is useless, but having a plan is indispensable.” I guess what that means is when the shit hits the fan you need to have a plan, but having a plan before the shit hits the fan is not that useful. It’s really a statement to the importance of resilience and agility. That’s what we really stressed in those six months. That’s how we got through it in better shape than when we entered it. Vuitton is a better company today than six months ago.

In what ways?

Well, it killed the last remnants of the past, of the [late] 20th century. That was not a good period for luxury. Financially it was — but we had strayed from the real values of luxury. It was about rolling out identical strategies; it was about replicating what you did in Paris; it was about standardising your windows and being very proud of it. It was about all these un-luxury values.

Some people have called that the “McDonaldisation” of luxury.

It’s quite clear, and it’s unfortunate that it’s correlated to size. I think you wrote about that, and it’s true, which is dangerous. Our ecosystem is absolutely dependent on suppliers and small,

upcoming houses that change and disrupt. If we start losing too many small brands and if we start losing too many suppliers, it’s going to weaken the entire ecosystem.

“Our ecosystem is absolutely dependent on suppliers and small, upcoming houses that change and disrupt. If we start losing too many small brands and if we start losing too many suppliers, it’s going to weaken the entire ecosystem.”

Size also comes with responsibility to do right by the people in your supply chain, the employees that work in your stores and in your factories, the planet, the communities we live in. How do you balance the priorities of various stakeholders now that it’s not only about optimising profit?

Yes, it’s a responsibility. The bigger and the more successful you are, the more you should be held to that responsibility, because satisfying all these stakeholders is only possible with a long-term approach. The problem is not compromising. You have to make compromises if you set realistic, short-term goals. If you have long-term goals you will satisfy all your stakeholders, so the responsibility boils down to long-term thinking. If you want to satisfy everybody, you can only do it by having a longer outlook than the market has.

What does it mean to be a responsible employer right now?

Well, from an employment perspective, it’s being mindful

of the type of jobs we’re creating. We create jobs but they have to be jobs that people actually want to occupy. So that goes to the work environment, that goes to the diversity of the job. The little

industrial revolution at Louis Vuitton has been that today, a craftsman will typically only work a couple of days or a couple of weeks on a different product. They will change to make other products in the course of a week or a month, which makes for a much more interesting job, much less repetitive. It reduces a lot of the stresses on joints and whatever problems you have when you’re actually making products. This is all made by hand. So there will be consequences of people working with hands and leathers and brass and nails and wood, [but] we need to make sure that environment is the best possible environment.

“If you want to satisfy everybody, you can only do it by having a longer outlook than the market has.”

I don’t know the last time you went to a Vuitton [atelier], but every centimetre is thought in those terms, down to the rubber

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mats they stand on, to the noise pollution. The noise levels have been divided by a factor of three in the last 10 years. The air quality, all of the actual physical work environment has to be appropriate for this day and age. The jobs have to be interesting.

The other thing is empowerment. When the crisis really accelerated, the only way to work [was] to fully empower people. The things that we've done in the last three or four months are good examples. The [Louis Vuitton menswear] show in Shanghai was cast locally and produced locally. The local teams were fully empowered to not just do a repeat show, but an original show. That show would have never happened before. We got away from this neo-colonial approach where everything happens in New York, London, Paris or Milan and gets trickled down through the various [markets] and they replicate; that's gone, that's finished.

I also turned every one of our 10,000 sales employees into store managers. We went into the crisis with 450 stores, we came out of the crisis with 10,000 stores, because every single salesperson, when they were stuck at home, we empowered them through software that we wrote in 10 days to not just interact with the clients, but also to actually close the sale. Each client advisor became a self-standing store with access to all the inventories throughout the zone, they could sell any product to anybody. So sales associates became store managers, a store managed by one person. This is how we were doing 30 or 40 percent of our business with all stores closed.

I saw the work that you've

been doing around gender equality, but what are you doing specifically on the side of racial diversity and representation?

“We went into the crisis with 450 stores, we came out of the crisis with 10,000 stores, because every single salesperson, when they were stuck at home, we empowered them through software that we wrote in 10 days to not just interact with the clients, but also to actually close the sale.”

I find that when you have a supposedly immovable problem one way of solving it is attacking it from both ends, which means hiring some very, very visible senior people and putting them in positions of power, not just representative positions, but actually power positions. In other words, they themselves will be able to hire; they themselves have substantial budgets. They themselves will be able to influence the messages that come out of the company, and you know I'm talking about Virgil [Abloh]. That's on one end of the spectrum and the other end of the spectrum is when we hire our junior executives, we need to make sure that we have the right balance.

Let's talk about the management teams though. At the very senior levels of companies like Vuitton, you are still just relatively homogenous as a group, especially when compared to the customer base that you're engaging with.

Not if you look in the stores, look at the store managers, it's very diverse and it represents

the client base. If you go in the studios, it's extremely diverse. White, heterosexual, middle-aged men are the minority. So it's happening. Does it still have a way

to go? Yes. Can we accelerate? Yes, but it's happening.

And, in this environment, how does Louis Vuitton think about engaging in politics? Thinking back to the opening of the Vuitton factory in Texas with Donald Trump and the reaction — not just from your consumers and followers on social media, but even Nicolas Ghesquière.

[Nicolas] has the right to have his own opinions, that's an absolute right at Louis Vuitton. I'm not going to muzzle him, but I can tell you that there were many people in America that disagreed with his comments, just like there were many people that agreed. At Louis Vuitton, you have the right to have your own opinions and actually to express them. How much better can I do than that? I think that is a very democratic approach.

How does all of this work so that you get it communicated to the ultimate stakeholder, your customers?

Louis Vuitton, seven or eight years ago, was, I would say, more

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introverted, in its bubble — very successful but a bubble. In the meantime, I think, Louis Vuitton has become a much more diverse environment, embracing diversity wholeheartedly. Vuitton is much more plugged-in with what's happening outside its own ecosystem, which nourishes the creativity that we see and which creates not just great PR and images, but also great relationships with clients that are truly high-end.

“The clients, they want immediacy, they want that transparency, they want authenticity and they want to be in the context.”

This has to do with opening up Vuitton to the world. Success breeds insularity and that's one of the things that you have to be very mindful of when you're in my job is to ensure that insularity does not become stifling. Insularity is good when it has to do with your provenance, where you come from, your uniqueness, but you have to battle to make sure that you stay plugged-in with what's happening around you all over the world.

That's why we embraced the digital world. Six, seven years ago, we were attempting to use the digital world to maintain one-directional communication from the brand to the client. Now, these social platforms have been absolutely embraced by Vuitton, but they're not run out of Paris. You can't; it's culturally impossi-

ble to do, logistically impossible to do. The clients, they want immediacy, they want that transparency, they want authenticity and they want to be in the context. They want to hear the message through their loudspeakers. So we went from being a fairly insulated, insular, successful company to a much more diversity-embracing company that is extremely successful in the digital world, which means being totally contextualised, totally empowered locally and extremely agile and quick, and not fixated on controlling every last piece of information, because that's just not possible.

Look out for the full interview with Michael Burke on The Business of Fashion in January 2021.

Disclosure: LVMH is part of a group of investors who, together, hold a minority interest in The Business of Fashion. All investors have signed shareholders' documentation guaranteeing BoF's complete editorial independence.

This interview has been edited and condensed.



05. TRAVEL INTERRUPTED

The travel retail sector remains severely disrupted and destination shopping suffered throughout 2020. With international tourism expected to remain subdued next year and shoppers experiencing further interruptions to travel, companies will need to engage better with local consumers, make strategic investments in markets witnessing a stronger recovery and unlock new opportunities to keep customers shopping.

Global tourism had been growing strongly prior to the pandemic, a trend that contributed to the importance of travel retail and destination shopping for the global fashion industry. In fact, travel and tourism growth outpaced GDP growth over the past decade, driven by strong growth in the Asia-Pacific region.⁹⁵ Before the pandemic struck, global airport sales were predicted to grow 6 percent in 2020.⁹⁶ Now, of course, all of that has changed, and international arrivals globally are expected to drop by 60 to 80 percent in 2020.⁹⁷

Disruptions have profoundly impacted tourism hotspots and the fashion retailers operating in them. Destinations across the Southern Mediterranean sub-region of Europe and its periphery saw a 73 percent decline in international arrivals in the first half of the year, while those in the Northeast Asia sub-region posted an 83 percent decline.⁹⁸ Across the board, popular destinations such as Thailand, Macau, Hong Kong and Singapore, all of which usually attract millions of tourists, saw very few arrivals. Hong Kong was particularly hard-hit, having welcomed 91 percent fewer tourists between January and September 2020 compared to the same period the year before.⁹⁹

Retailers in other major shopping hubs have also seen significant losses, as high-spending tourists from China, Russia and the Middle East

stayed away from European fashion capitals like Paris, Milan and London. French luxury department store Galeries Lafayette said it was facing a €1 billion (approximately \$1.17 billion) loss in 2020, while its Italian counterpart La Rinascente expected a 20 to 25 percent drop in annual revenues.¹⁰⁰ “There are some great [shopping] districts around the world [but] it’s a real problem for districts to reinvent themselves [now],” said British department store Selfridges Group Managing Director Anne Pitcher.¹⁰¹

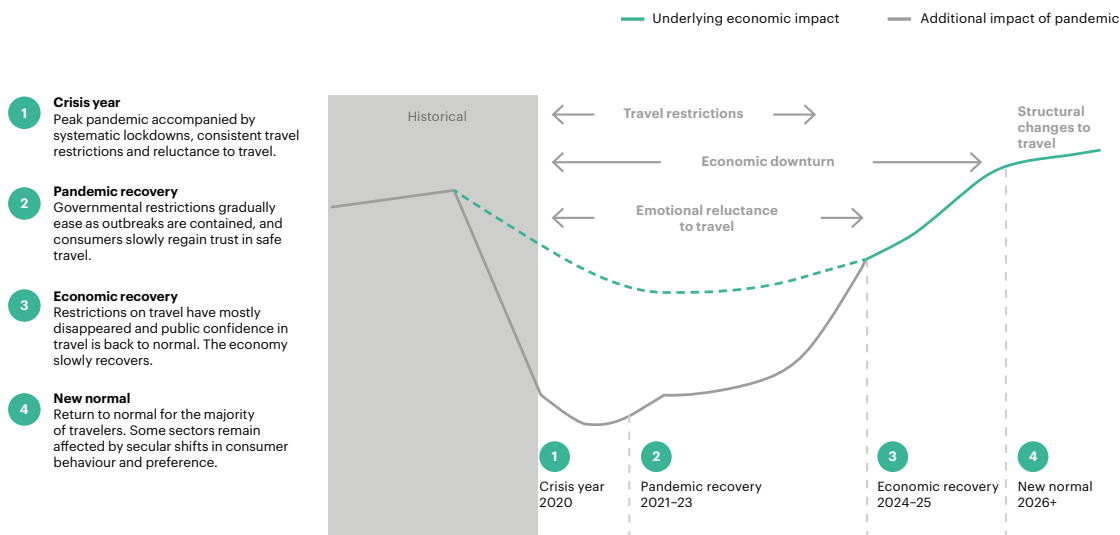
Retailers in other major shopping hubs have also seen significant losses, as high-spending tourists from China, Russia and the Middle East stayed away from European fashion capitals like Paris, Milan and London.

Scenario modelling by McKinsey and Oxford Economics suggests the pandemic lifecycle of the travel industry will consist of four stages: a crisis period, a recovery from the pandemic, a recovery from the economic downturn, then eventually a new normal, with the recovery’s timing and pace varying across regions (based on information available September 2020).¹⁰²

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Exhibit 7:

Travel recovery is expected to evolve across four stages, with both economic and health factors reshaping the market



SOURCE: MCKINSEY TOURISM RECOVERY MODEL, MCKINSEY TRAVEL LOGISTICS AND INFRASTRUCTURE PRACTICE

Uncertainty is expected to continue into 2021 and recovery will likely be focused initially on domestic and neighbouring-country travel. However, international tourism may not return to pre-pandemic levels before 2023 or 2024. This chimes with fashion executives' sentiment about the recovery timeline for the travel retail sector. In our BoF-McKinsey State of Fashion 2021 Survey, 66 percent of executives expect it to take at least two to three years for travel retail sales to recover to their former growth levels.¹⁰³

The faster recovery of domestic and nearby-country travel already began to play out in 2020. In China and Europe, intra-regional travel picked up over the northern hemisphere summer, which saw a gradual increase in the number of flights.¹⁰⁴ Booking of domestic flights in China recovered to pre-Covid levels in August and more than 600 million people

travelled during China's National Day Golden Week in October,^{105 106} providing some support to domestic retail.^{107 108 109} In North America, more than 90 percent of trips in August were undertaken by car, revealing the extent to which consumers shifted to domestic travel.¹¹⁰

However, not all markets will recover at the same speed or to the same extent, as some are more dependent on global shoppers than others. The slower recovery of luxury sales in Europe compared to other geographies highlights the impact of absent luxury consumers, especially those who normally travel from China and other Asian countries. Even in a positive scenario, Europe is expected to see its luxury sales decline by 23 to 28 percent in 2021 compared to 2019 in the Earlier Recovery scenario.¹¹¹

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With global travel hubs expected to remain relatively quiet throughout 2021, shopping at duty-free and luxury outlets will continue to shift towards China as retailers in these sectors double down on their efforts in the wider region. Swiss duty-free retailer Dufry, which was replaced as the world's number one by China Tourism Group DF in 2020,¹¹² plans to focus its recovery on Asia. In 2020, Hong Kong-based DFS Group acquired a 22 percent stake in Shenzhen Duty Free Ecommerce Co, signalling the growing importance of mainland hubs. Outlet player Value Retail said in April that China was a priority, after seeing strong growth in 2019 and in the period after lockdown in 2020.¹¹³

In North America, more than 90 percent of trips in August were undertaken by car, revealing the extent to which consumers shifted to domestic travel.

“Mainland China has become the place where all the purchase power is trapped,” said Mauro Maggioni, Asia-Pacific CEO of Golden Goose.¹¹⁴ The Italian luxury sneaker and apparel brand is planning to open a store in Hainan, a tropical island in southern China, which is attracting major investment as a domestic tourism hub.

Given that footfall in destination stores and travel retailers will remain dampened by the decrease in tourists, brands will need to think creatively about how to address the “discovery problem” that will emerge in the customer's path to purchase. In a bid to tackle this, some players are devising ways to get closer to their priority consumer groups. Brazilian beachwear brand Havaianas, for example, announced a \$50 million investment to increase its footprint and visibility across the Asia-Pacific region.¹¹⁵

Some players that have relied heavily on international tourism will continue to adjust their offerings to cater to the local market, in a bid to woo

domestic customers. We therefore expect to see changes to assortments, in-store staff profiles and marketing.¹¹⁶ Galeries Lafayette, which previously generated 50 percent of revenue from international tourists, said it will focus on Parisians and French tourists for the 2020 holiday season.¹¹⁷ US department store Bergdorf Goodman has similarly developed new initiatives targeting affluent New Yorkers, and started offering same-day delivery to the Hamptons during the summer.¹¹⁸

Meanwhile, retailers with a high share of products associated with holidays and travel will continue to adapt their offerings. Samsonite Group, for example, has said it will shift away from suitcases and towards everyday products like day-to-day bags.¹¹⁹ Luxury brand Rimowa started its own sunglasses line, extending its product range beyond its recognisable aluminium suitcases.¹²⁰

As consumers continue to settle into travel restrictions and ongoing social distancing measures in 2021, brands should develop short- and medium-term responses to this new environment and align their assortment with evolving consumer demands. They should carefully monitor regional trends to capture opportunities, such as new domestic travel patterns and short shopping trips.

But fashion brands should continue to prioritise engagement on a local level, both in their home markets to compensate for the lack of tourism and overseas to reach customers where recovery from the pandemic is gaining ground. Despite a positive outlook in China, brands should not make hasty decisions about the market; instead they should plan a strategic approach informed by the latest market intelligence that will differentiate them from their peers over the longer term.

Finally, executives must also start planning for a post-Covid world by ensuring that they will be able to capitalise on the excitement that is unleashed once the pandemic is over, as consumers return to long-haul destinations and large social gatherings such as weddings, festivals and cultural events.

Selfridges Group: Managing the Pivot to Local Shopping



Anne Pitcher
Managing Director, Selfridges Group

With the retail ecosystem in flux, even the strongest players are endangered by the pandemic and its aftershocks. The boss behind UK-based Selfridges Group, whose portfolio includes luxury department stores across Europe and Canada, explains how customer-centric thinking and a return to local shopping could unlock retail's recovery.

— by Sarah Kent and Hannah Crump

Selfridges had ambitious plans for 2020. The luxury department store chain had emerged from a decade of retail disruption in a better position than many competitors and was preparing to launch a grand new strategy focused heavily on sustainability to drive future engagement and growth. The pandemic hasn't changed that conviction, but it has delayed the retailer's plans and put it in a more precarious position.

With five department store businesses under its umbrella — Selfridges in the UK, Arnotts and Brown Thomas in Ireland, De Bijenkorf in the Netherlands and Holt Renfrew in Canada — the Selfridges Group is in the eye of the global retail storm. Not only are its stores located in historically busy, city-centre locations where high-spending tourists are now largely absent, luxury sales remain in a slump across most of its markets. Amid the gloom, Managing Director Anne

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Pitcher says she also sees exciting opportunities.

Some industry commentators say that this is an opportunity to reinvent retail. How do you see the industry evolving in the coming years?

Retail is part of an ecosystem, isn't it? Retail depends in part on office workers being back in the office, and there's also a materiality attached to international travel. Most importantly, how the customer wants to shop and what is important to us as individuals is changing the entire business model. What was bad in retail before is probably not going to survive. What was super challenged before is definitely not going to survive. What was good before probably will, but we will have to reimagine the way we do retail, reimagine the way we sell, reimagine our business models completely, if we're going to respond to all of these changing behaviours.

Let's not hide from the truth. It's really hard. I always try and advocate that a great business relationship is one where both do well, where both succeed, [by] trying to find a way where both generate profitability. It doesn't always work. Some of our most important partners are in terrible difficulty. That leaves a big hole in our mix, but there's lots of opportunity out there as well. I hope many people would say of our businesses that we pay our bills, and that's a good start. I would like most to say we're fair. Fair but tough is a good place to be.

There's so much talk about "rewiring" the fashion industry. How is that affecting business from a buyer's perspective?

Buyers and wholesalers are having a really tough time right now. This is where a level of trust is emerging as critical to the relationship and will make us stronger in the longer term. The reality is, no retailer has

of years at least to bed in, and somebody will always want to get there first. We will have later spring deliveries, which is going to make the whole Black Friday week and Christmas, hopefully, look very different. We don't have Black Friday in our group, but we've all been trying to reduce the scale of activity that peaks around Black Friday week. It's unsustainable, absolutely unsustainable.

Are people going to buy as many clothes as they used to through the rest of the pandemic and afterwards or do you think apparel should have a smaller part in the merchandise and service mix in stores? In other words, was the opening of Selfridges' bike shop in London during the pandemic a sign of things to come?

We cannot continue to consume at the rate we have, so there is a huge question that we need to answer. We will probably end up selling less, won't we? At the moment, we are still selling very beautiful things, so I think it's a question of choice, not always, "Can I afford it?" The throwaway [purchase] is definitely, for us, slowing down but [buying something] that will last for years, I think that is definitely going to emerge. If we are going to sell less, what are we going to put in these great big spaces that are shops? We've got loads of things we can do, and the experience sits at the centre of that thinking.

What kind of experiences, particularly in a socially distanced world?

Department stores are lucky, because they are by necessity big, open spaces. There's still so much art, food, culture, conversation,

"We cannot continue to consume at the rate we have, so there is a huge question that we need to answer. We will probably end up selling less, won't we?"

This year, Selfridges has set targets for brands stocked in its stores to meet minimum sustainability standards by 2025. That's a big ask. At the same time, you've also had to make some difficult decisions over the last few months about order volumes and product mix. How do you manage that kind of relationship in a sustainable manner and with respect?

received enough stock quickly enough, which is forcing much longer sale periods before stock is replenished. We've probably all made more profit out of having a longer sale, but only because new [product] hasn't been delivered as soon as it was [previously]. That's good, except we haven't taken in as much money because we haven't had the new deliveries. I think a new business model is emerging. It'll take a couple

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relevance. We've used our cinema non-stop to create conversations. The skate park is still fully booked. There's a lot more that people can do in a space than just buy stuff. Being together, even if socially distanced, is one of the main ones. For anyone to go out, there needs to be a purpose and that's how we need to think about the way we do business.

What about international travel and tourism? In the past, Selfridges has invested heavily in wooing international customers, with translations, multilingual staff, tax-free shopping services and so on — not only for the London flagship but for its branches in Birmingham and Manchester. How do you manage the decline and what do you need to do to entice local customers more?

It's [an] opportunity to focus on your local customer and your domestic marketplace again. That's why I would point to the recovery being stronger outside capital cities. All of our businesses are very local, but there is a huge opportunity to continue to build domestic business. You can start with a pretty strong assumption that digital is going to continue to over-deliver on 2020 plans, so [there will be] more investment in digital, more investment in acquiring, attracting and growing a relationship with domestic customers. One of the things we have done well in the past is invite people into the store for events. We've found that we've reached a much wider audience with some of our recent digital conversations, turning them into customers of the future.

“We put our thinking in the hearts and minds of our customers and try to bring a conversation to life with them that touches how they feel.”

At least for the foreseeable future, online is so much more important. There are already quite a few established online luxury marketplaces, how does Selfridges distinguish itself in that space and become a destination digitally in the same way that it is physically?

Somebody said to me, “How do you turn a department store into a customer store?” [Customers] don't care how they shop, really. They definitely care about who they shop with, and why they would shop with that business, brand or person. I think that's what we do. We put our thinking in the hearts and minds of our customers and try to bring a conversation to life with them that touches how they feel. I've always believed that being able to bring a brand to life for a customer, however they want it, whether they want to go in the shop, have a social day out with a friend, or whether they want to sit at home and buy online, I think it's the same, in a way. Our strength is we have both, and I believe wholeheartedly that the more we can knit the two together, the stronger we will be.

But what if international travel can't really pick back up, and the UK is in a deep recession?

Well, there's going to be fewer people. There's going to be fewer retailers, let's be clear. There's probably going to be less money spent. It's going to be hard and it's going to be long. I would say that you want to recover to where you were in two or maybe three years. If you don't get back to where you were in 2019 within that period of time, it's going to be a pretty long journey ahead. We've done better than we thought [this year] but we haven't done well enough. I guess I am more confident about the roadmap ahead on the basis of what I've seen, but I'm equally concerned that an earlier Covid 2.0 could really disrupt us even further. I think the point is, whilst we're clear on what's happened, we cannot have any clarity over what, let's say, the next 12 months is going to look like. If international travel doesn't happen before 2022, it's going to be very long and very hard [for all of us]. We will need to focus far more on our communities and our relevance in our domestic market, and we'll all need to try new models.

This interview has been edited and condensed.

FASHION SYSTEM

06. LESS IS MORE

07. OPPORTUNISTIC INVESTMENT

08. DEEPER PARTNERSHIPS

09. RETAIL ROI

10. WORK REVOLUTION



06. LESS IS MORE

After demonstrating that more products and collections do not necessarily yield better financial results, Covid-19 highlighted the need for a shift in the profitability mindset. Companies need to reduce complexity and find ways to increase full-price sell-through to reduce inventory levels by taking a demand-focused approach to their assortment strategy, while boosting flexible in-season reactivity for both new products and replenishment.

Even before Covid-19, the fashion industry had been edging towards a dangerous threshold. Excessive inventories and widespread markdowns proliferated to the extent that just 60 percent of garments were sold at full price, creating billions of dollars of lost revenues and margin.¹²¹

During the pandemic, the situation worsened. Inventory levels increased significantly despite brands' and retailers' scrambles to implement damage control.¹²² Inventory turnover fell by 33 percent in the first three months of 2020,^{123 124} and orders were down nearly a third year-on-year by the end of April.¹²⁵

Few fashion players were immune as markdowns proliferated across all value segments and product categories.

Few fashion players were immune as markdowns proliferated across all value segments and product categories. Gap, LVMH and Brunello Cucinelli are among those to have announced substantial inventory impairments as a result of the pandemic.^{126 127} While some businesses found creative ways to clear unwanted stock — such as

dedicated websites like Ganni's, which sell past seasons' collections at a discount,¹²⁸ or through pop-up outlets like Harrods — other brands, from PVH and Michael Kors to Gap and Versace, are holding onto excess inventories in the hope of an uptick next year.^{129 130}

"In uncharted times such as these you need to be brave and decisive. Harrods Outlet has provided us with an innovative solution to a completely unprecedented, and unforeseen, issue," said Michael Ward, Managing Director of Harrods.¹³¹

The overstock issue will only get worse in the future if companies fail to adapt to the consumer's new mindset. Consumer attitudes are changing in the wake of the pandemic, as many embrace a "less is more" approach that coincides with industry changes in the fashion cycle. Some 65 percent of consumers in a McKinsey survey conducted during the Covid-19 crisis said they plan to purchase more long-lasting, high-quality items, and overall, consumers considered "newness" one of the least important factors in making purchases. The pandemic has not only accelerated a pre-existing critique of consumerism, but also the increased importance of sustainability in purchasing decisions, and the rise of circular business models (especially resale).¹³²

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As Farfetch Founder and Chief Executive José Neves said in July 2020 on The Business of Fashion Podcast, “the industry has an oversupply problem, which is an environmental problem as well.”¹³³

Due to these and other factors, brands will need to focus on three key priorities in the year ahead: accelerate their shift toward a demand-led model, reduce assortment complexity and address the recalibration of the price-volume equation.

Brands will need to focus on three key priorities in the year ahead: accelerate their shift toward a demand-led model, reduce assortment complexity and address the recalibration of the price-volume equation.

In a bid to better match consumer preferences, brands will increasingly leverage technology and analytics to gauge consumer sentiment prior to production. Several brands have already taken steps toward basing product development on consumer insights and analytics and, at times, coupling these with made-to-order models.

“The higher the percentage of made-to-order business, the less overproduction you’re going to get involved with. That’s the first thing that luxury needs to concentrate on; smaller runs, ideally a run of one,” said Louis Vuitton Chief Executive Michael Burke.¹³⁴ “It’s maybe pie in the sky to actually hit 100 percent with that, but that should be a goal.”

Meanwhile, Reebok has tested its designs with consumer votes, making production contingent on votes passing a minimum threshold of demand.¹³⁵ At the same time, made-to-order models adopted by smaller brands like French label MaisonCléo or US brand Stöffa are increasingly being trialled by larger brands.^{136 137} Several others, including Nike and

Telfar, have leveraged pre-orders and just-in-time production models, in which consumers purchase items before they are produced and receive them several weeks or even months later.¹³⁸

Analytics and artificial intelligence will also gain traction in the product development process as data becomes more available to brands and designers become more skilled at using data. Footwear and apparel brand Wolverine plans to optimise assortments with digital consumer testing based on First Insight’s predictive analytics, where voice of the customer (VoC) feedback is combined with artificial intelligence.¹³⁹

With 60 percent of fashion executives in our BoF-McKinsey State of Fashion 2021 Survey planning to implement improved analytics for consumer insights and 43 percent planning to reduce product development lead times to avoid overstock, (Exhibit 8) it is clear that there is a movement underway to transform the supply chain. Wholesale pre-orders will increasingly be kept low while open-to-buys will increase, creating an opportunity to bring in the latest products consumers want or to replenish bestsellers.

The reduction of SKUs is mentioned by more executives (61 percent) in the survey, as complex assortments are inherently problematic.¹⁴⁰ Such assortments create long tails of unproductive SKUs, detract from core products and cause bottlenecks in the system and in-store. They also muddy the waters in respect of strategy, communication and formats. Nonetheless, brands have continued to expand their assortments in recent years, often due to the “fear of missing out” on new trends, or in order to launch a new item during a key sales period.

In 2021, we will see brands applying smarter approaches to assortment, aiming to reduce complexity and realign collection drops with clear consumer opportunities. Some brands that have already begun this process include Victoria Beckham, which has said it will cut SKUs by 30 to 40 percent, Nike, which has streamlined product lines to improve SKU productivity by 15 percent,^{141 142}

06. LESS IS MORE

and Coach, which plans to cut 50 percent of its holiday season collection.¹⁴³ In July, the SMCP group announced it would cut its inventory purchases by 30 percent for the FW20 season.¹⁴⁴

In 2021, we will see brands applying smarter approaches to assortment, aiming to reduce complexity and realign collection drops with clear consumer opportunities.

Another way brands are streamlining their assortment is by breaking the shackles of the traditional fashion calendar. Indeed, the current number of collections across the seasonal calendar is increasingly seen as an impediment to a demand-focused approach. Echoing the sentiment of 30 percent of executives responding to our survey, Off-White, Tory Burch and Mugler are among the brands that have announced departures from the seasonal schedule, enabling them to regain control of in-store delivery.^{145 146}

As luxury players focus their energies on fewer yearly collections, some are shifting away from cruise and resort collections. As the trend continues into next year, brands heavily reliant on these inter-seasonal collections will face the challenge of having to adapt to a reduced fashion calendar. Gucci announced it would be scaling back the rhythm of its collections from five to just two per year, reflecting a growing movement toward seasonless fashion among retailers;¹⁴⁷ this is underlined by results from our BoF-McKinsey State of Fashion 2021 Survey, which reveals that two fifths of executives plan to make the move. This adds to a growing chorus of brands and designers calling for the fashion calendar to be rewired, such as the Dries Van Noten-led Forum Letter to the fashion industry and the #RewiringFashion initiative facilitated by BoF.^{148 149}

However, to solve the underlying overstock

problem brands need to capture more value, and this means striking a new balance between pricing and volume. There are two levers at their disposal: the reduction of discounts and the optimisation of prices (price increases for brands that have not yet reached the limit of fair value).

After the discount drive of the early phase of Covid-19, the next phase saw a revision of price points and the implementation of “no sale” strategies to safeguard margins. Some direct-to-consumer brands, including US-based Dôen and French label Sézane, have built their success on the absence of end-of-season markdowns, relying only on occasional “archive” and sample sales.¹⁵⁰ Some luxury brands, meanwhile, have room to leverage their desirability to lift prices. Although these strategies overlap with brands’ broader price harmonisation plans, the willingness to capture more value from key products appears to be the main rationale of recent price increases.

“Our pricing policy of staying at the European level remains unchanged. Russian customers should not be penalised for shopping in Moscow [rather than] in Paris or Milan,” said Alexander Pavlov, chief executive of Tsum department stores in Russia, which are managed by Mercury Group.¹⁵¹ “We believe that practice of markdowns and price reductions in the full-price stores has [a] negative effect on long-term business; we constantly discuss it with our partners.”

Value and mid-market brands have been more reluctant to ditch markdowns. However, they are adopting more sophisticated, tailored pricing strategies with levels and duration of discounts informed by market and consumer data harvested by analytics and artificial intelligence. Levi’s has reported significant benefits from its optimised, data-driven approach to markdowns, with some promotion events generating four times the profit of similar initiatives from the previous year.¹⁵² Meanwhile, some smaller labels have taken more control of pricing with concession models on online marketplaces.

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The events of 2020 have highlighted that more is not always better. Indeed, they have shown that brands that reduce complexity and rely less on discounting as a way to prop up sales often outperform those that do not. When combined with a demand-focused approach and intelligent assortment management, the overall impact is a more streamlined business model that is better suited to the global market.

In 2021, we expect brands to sharpen their assortment using high-quality analytics, and to test

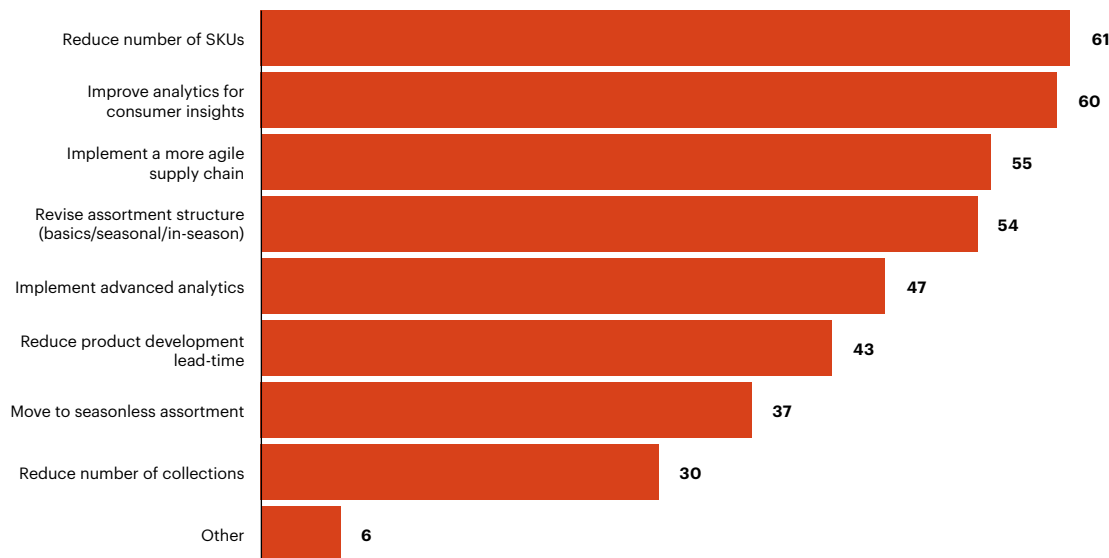
more products with consumers ahead of production. Brands will focus on accelerating speed to market and on aligning launches and product drops with their customers’ needs rather than the traditional fashion calendar. This will lead to a permanent change in mindset among consumers.

Moreover, brands will need to become nimbler to pursue price optimisation and manage markdowns in a smarter way as they adopt a more measured and sensible approach to production in the wake of the industry’s new mantra: “less is more.”

Exhibit 8:

Fashion executives plan to employ several strategies to avoid overstock in the future

% OF RESPONDENTS



SOURCE: BOF-MCKINSEY STATE OF FASHION 2021 SURVEY

A More Circular Fashion Industry Will Require a Collective Effort

As consumers become more engaged with sustainability issues, circularity will be the key that unlocks the door to a more sustainable future.

by Libbi Lee and Karl-Hendrik Magnus

Key Insights

- With garment production volumes growing by 2.7 percent annually and less than 1 percent of products recycled into new garments, action on circularity is an imperative.
- Despite challenges with garment durability and logistics, pioneering brands are driving circularity from the drawing table to e-commerce search filters.
- All fashion value chain stakeholders have a role in driving the circularity revolution — we expect it to be the next disruption, and it's for individual brands, manufacturers, aggregators and marketplaces to capture the opportunity before others.

When it comes to protecting the environment, the fashion industry knows that “less is more,” meaning the less impact we have on our planet, the more benefits will accrue for businesses, people and natural life. One promising way for fashion to reduce its environmental impact is by scaling circular business models, through which companies employ a range of strategies to reduce waste and make more efficient use of resources, as well as help their customers to do so, too. In 2021, we see circularity moving from the fashion fringes towards centre stage.

The impetus to act on the environment is emphasised by shifting consumer attitudes. More than three in five consumers in a recent McKinsey survey said environmental impact is an important factor in making purchasing decisions.¹⁵³ Regulators and policy-makers are also on board, amid a raft of upcoming initiatives to promote circular practices (such as in the EU) and prohibit

the destruction of luxury goods, as can be seen in France. More generally, measures such as the EU's carbon border tax will promote circularity by making the economics of onshore recycling and other circular models more attractive.

More than three in five consumers said environmental impact is an important factor in making purchasing decisions.

An industry-wide circular business model is a lofty ambition — and is a long way from being realised. Despite efforts by some players, as much as 12 percent of fibres are still discarded on the factory floor, 25 percent of garments remain unsold, and less than 1 percent of products are recycled into new garments.¹⁵⁴ Given these metrics, action is an imperative and an inevitability. Indeed, circularity

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may become the biggest disruptor to the fashion industry over the next decade.

As the industry makes progress with the “Rs” — reducing, recycling, refurbishing, reselling, renting and repairing — few decision-makers are under any illusion about the scale of the challenge. Despite good intentions on the part of some players, garment production volumes are predicted to grow by 2.7 percent annually between now and 2030.¹⁵⁵ The priority, therefore, must be to set circular strategies, tackle scalability challenges and take concerted action to scale solutions.

The Challenges in Scaling Circularity

The way in which value is created in circular systems is radically different to the way it is created in linear systems. In essence, a single garment can create value repeatedly — through sale and resale, repeated rental, or being sold, repaired, returned, refurbished or recycled, and resold again to start the loop over. This value-multiplier effect has prompted several leading retailers to get involved. Selfridges’ Project Earth initiative aims to help customers buy “pre-loved” items (in its Resellfridges range) or rent (through partner Hurr Collective) and repair. Peer-to-peer social shopping resale app Depop saw a 300 percent year-over-year increase in items sold during the Covid-19 pandemic, reflecting rising consumer demand for pre-owned purchases.¹⁵⁶

With some of the industry’s leading names showing interest, there is little doubt that circularity is gaining momentum. However, three key barriers are preventing adoption at scale:

Capturing value requires durability or recyclability. Without durability or recyclability, there is likely to be significant erosion of product value. Refurbished products can command relatively high prices if the refurbishment is carried out reliably, which is not always easy when clothes are stretched or stained and accessories scratched or marked.

Similarly, with most garments composed of a mix of materials, recycling is not easy.

Enabling circularity involves a complex web of logistics. Resale transactions are currently mostly peer-to-peer, with individuals deciding whether the resale value is worth the time and energy required to wash, photograph, describe, package and send. In “Fashion on Climate,” our analysis showed that, to align with the 1.5-degree pathway in 2030, 20 percent of garments need to be traded through circular business models, so greater scale is required.¹⁵⁷ The subscription rental model, for example, requires many users for the economics to make sense — and again, the key challenges are logistical, including laundry and delivery.

Engaging consumers requires overcoming stigmas. While circularity is winning fans among some consumer groups, it is still an abstract idea to most and terms such as recycled, upcycled, repaired and refurbished still have negative connotations. Similarly, consumers are willing to return recent purchases with the incentive of a refund, but struggle when a garment of unknown value sits forgotten at the back of a wardrobe.

As much as 12 percent of fibres are still discarded on the factory floor, 25 percent of garments remain unsold, and less than 1 percent of products are recycled into new garments.

What Will It Take to Scale Circularity?

The apparel ecosystem is fragmented, with no single player accounting for more than 1 percent of the market. Standardised solutions, therefore, are unlikely to emerge anytime soon. More probably, we will see a variety of strategies led

by a diverse cast of actors and predicated on three foundational capabilities:

Embracing Sustainable Design. Circularity starts on the drawing board, and with the textiles and materials that designers use for their creations. One company that has embraced the sustainable design ethic is London-based Dai Wear, which employs recycled and recyclable fabrics to produce performancewear. The company uses biodegradable yarns for seams and air-dried fabrics to reduce washing needs.

“Sustainability is obviously more important than ever, but it is also becoming the baseline requirement for all apparel companies,” Dai Wear Chief Executive Joanna Dai said. “We find increased organic engagement and followers slightly outside of our core target niche who align with our values and buy into our brand.”

Designing for zero waste requires material and product innovation. Scotland-based Johnstons of Elgin recently introduced EveryYarn, a material made from used yarns. “Our objective is that every yarn that we make is made into a finished product,” says Chief Executive Simon Cotton. “Demand for the range has certainly passed our expectations, but it requires channels where the limited-edition nature of the product is accepted and the availability of colours drives a certain idiosyncratic design. That said, we do get some brilliant designs working this way but it’s not suitable for conventional merchandising or stock-supported wholesale models.”

Companies should:

- Invest in, incubate, pilot and test alternative materials and processes for a circular system;
- Radically reduce production waste and support, train and incentivise suppliers to reduce and reuse fibre, chemicals and packaging;
- Reskill designers and stimulate circular design innovation;
- Create momentum by collaborating and developing tools.

Ramping-Up Reverse Logistics. Through reverse logistics, companies can recover items from disposal or secondary resale and thereby continue to derive value. Brands often partner with intermediaries to operationalise the process. Patagonia works with start-up Trove to buy-back items and sell them at a reduced price. Trove can purchase, process, price and photograph second-hand goods before putting them up for sale on clients’ websites. Used-clothing platform ThredUp has partnered with companies including Reformation and Amour Vert to enable customers to send clothes (from any label) in exchange for shopping credits. In the rental space, US-based logistics company CaaStle manages the entire process for companies, from warehousing and cleaning garments to gathering customer feedback.

Some companies are leveraging their own store networks for circularity, although very few also rent, repair or resell in store. UK-based Mulberry has maintained a leather library since it launched in 1971, offering repair and refurbishment for all its products. In 2020, the company launched Mulberry Exchange, a buy-back initiative under which customers can return bags to be repaired and resold alongside the current collection.

Companies should:

- Design reverse logistics to optimise value retention, either by partnering with a trusted intermediary or — more likely in the luxury space — taking direct control;
- Leverage store networks to create in-store circularity hubs;
- Build out non-store collection points and home pick-ups to improve accessibility;

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- Optimise sorting facilities and recycling technology, either in-house or with partners;
- Eliminate single-use packaging.

Circularity is likely to be one of the key business trends of the next decade. However, it is not the kind of revolution that can be led by a few leaders, while others wait and see.

Supporting Customer Adoption. For younger consumers born into the sharing economy, adopting circularity is a natural step. However, older consumers may require education and encouragement. Some consumers believe there is a hygiene issue with second-hand clothes, and others struggle to translate their sustainable values into actions for a wide range of reasons.

Some brands are responding by marketing circular items alongside conventional ranges, for example Patagonia. Zalando and Selfridges, meanwhile, are scaling a range of circular offerings in their core businesses, helping to normalise circularity in the minds of shoppers.

As circularity grows, digital enablement will be critical. As the traditional linear fashion value chain transitions into a circular system, consumers will be incentivised to engage beyond an initial purchase in order to engage in circular business models, which in turn will support data collection that can shape a brand's business going forward.

Companies should:

- Offer rental options such as subscription services and the option to buy rented products at a discount;
- Borrow online marketplace techniques to

filter, sort and group assortments, or leverage retailer-curated collections;

- Enable peer-to-peer business, including resale and rental, and sweeten the deal with logistics and digital solutions;
- Create timeless collections, reflecting the declining prominence of seasonality;
- Offer tips for care and repair;
- Enable returns and recycling;
- Develop data strategies to inform business decisions.

Driving the Future of Circularity

Circularity is likely to be one of the key business trends of the next decade. However, it is not the kind of revolution that can be led by a few leaders, while others wait and see. Rather, a collective effort is required, in which fashion companies, customers and all participants in the value chain collaborate.

To date, players that feature sustainability in the centre of their branding have been at the forefront of circular practices, as well as some established luxury brands owing more so, perhaps, to the resale value of their stock rather than their eco aspirations. However, looking forward, we expect mass-market brands to scale their efforts. In addition, aggregators are well-placed to launch resale and repair programmes, combined with an enhanced in-store experience. Marketplaces can build on their size and logistical capabilities. As consumers become more engaged with sustainability issues, circularity will be the key that unlocks the door to a more sustainable future.

The authors of this article focus on Sustainability in Apparel, Fashion and Luxury, including McKinsey's research partnership with the Global Fashion Agenda on 'Redesigning Growth'.

07. OPPORTUNISTIC INVESTMENT

Performance polarisation in the fashion industry accelerated during the pandemic as the gap widened between the best-performing companies and the rest. With some players already bankrupt and others kept afloat by government subsidies, we expect M&A activity to increase as companies manoeuvre to take market share, unlock new opportunities and expand capabilities.

Even before Covid-19, fashion was a winner-takes-all industry. In 2019, the top quintile accounted for 200 percent of the industry's economic profit, while the remainder made a negative contribution, meaning they lost money (see the MGFI on page 108).¹⁵⁸ Some 34 percent of listed fashion companies were already showing signs of distress pre-crisis.¹⁵⁹ During the early phase of the crisis, from March to September 2020, we witnessed a "Darwinian Shakeout," with at least 20 major companies entering bankruptcy restructurings at a wide range of fashion companies including US retailers Century 21 and Ascena Retail, British department store Debenhams,¹⁶⁰ Dubai-based e-tailer The Modist and Japanese apparel maker Renown.^{161,162}

Some 34 percent of listed fashion companies were already showing signs of distress pre-crisis.

The industry's mid-pandemic economics could be set to get a lot worse. Listed fashion companies representing around \$50 billion of revenue are loss-making or incurring unhealthy levels of debt, according to McKinsey Fashion Scenarios (based on information available September 2020). For years, mid-market brands

have been squeezed as profits concentrated around the luxury and value segments. Similarly, brick-and-mortar retail has been on a long downward trajectory, with department stores on the front line, leading to many relatively small but healthy brands coming under pressure from declining wholesale demand.¹⁶³ Some of these are building direct-to-consumer offerings, but that takes time and investment.

With governments around the world considering winding down official support schemes and with the development of vaccines and drugs still ongoing, the future looks uncertain. We estimate that under a partial-support scenario, around 50 percent of companies would show signs of distress. Without any subsidy at all, the situation would almost certainly be worse. Europe could see as many as three in four companies facing existential challenges.¹⁶⁴

While many distressed companies face bankruptcy and liquidation, some may emerge from restructuring with a relatively clean balance sheet, without huge debt burdens and with an opportunity to rebalance the business. Both Neiman Marcus and J.Crew have filed for bankruptcy and emerged cleaner as a result, the former having shed \$4 billion of debt and the latter with a new majority owner and \$1.6 billion of debt converted to equity.^{165,166} Neiman Marcus Group Chief Executive Geoffroy van

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Raemdonck described it as a “defining moment” for the American department store on The Business of Fashion Podcast amid the company’s bankruptcy proceedings.¹⁶⁷

A market landscape with fewer players will lead to share gains for those who remain, a trend that stronger companies like to highlight to investors to soften pandemic sales results. Strategies to capture market share from competitors hit by Covid-19 have been announced by department store chains Kohl’s and Bloomingdale’s,¹⁶⁸ with the latter believing that \$10 billion in market share is waiting to be taken.¹⁶⁹ If we assume more bankruptcies are inevitable, a likely accompanying trend will be consolidation, with cash-rich players able to pick up assets at relatively low prices. This would echo the pattern seen after the 2008 financial crisis, but the magnitude is likely to be greater this time around, with potential targets counted in their thousands.¹⁷⁰

When it comes to M&A strategy, there is likely to be a focus on deals that offer upside in the “new normal” market environment that emerges out of the pandemic crisis.

When it comes to M&A strategy, there is likely to be a focus on deals that offer upside in the “new normal” market environment that emerges out of the pandemic crisis. While there will be many motivating factors for the selection of acquisition targets, we see three primary drivers: consolidation for market share through new categories or geographies, gaining or strengthening new routes to market, and acquiring new capabilities.

Stronger companies will focus on category and geographic expansion, targeting players with robust brand equity and with a diversified footprint from the acquirers’ home markets. Often, acquirers target companies that have a similar business model or channel focus, which is likely to

make integration easier. Previous crises have led to some smart consolidation deals. Nike, for example, purchased Converse in 2003, following the dotcom crash, and grew the brand’s sales tenfold, while Gap Inc. bought athleisure line Athleta in 2008, in the wake of the global financial crisis. Similarly, India’s largest retailer, Reliance Retail, was reportedly “in talks” with bankrupt UK department store chain Debenhams in September 2020 about a potential takeover.¹⁷¹ Historically, this type of deal has been the most prevalent motivation for takeovers.¹⁷²

Opportunistic acquirers will strengthen their positions in booming e-commerce and direct-to-consumer markets, as was seen in June 2020 when Boohoo Group snapped up the direct-to-consumer businesses and intellectual property of fellow UK brands Oasis and Warehouse, while leaving their costly store network out of the deal.¹⁷³ In September, Boohoo was reportedly eyeing New Look with the same strategy in mind. Among vertical deals this year, French label Naf Naf was sold to its Turkish supplier SY International, and US mall operator Simon Property Group bought parts of Brooks Brothers and denim retailer Lucky Brand.

In a small but significant proportion of cases, the motivation for M&A is to acquire capabilities, for example in technology, payments, supply chain functions and craftsmanship. The latter may emerge as a dominant M&A theme among luxury companies. French Legacy Group bought shoe brand Clergerie in July, citing interest in not just the brand, but also the factory of 112 artisans in Romans-sur-Isère.¹⁷⁴

If the potential to undertake M&A was based on financial resources alone, companies in the running for deal-making would include LVMH, Fast Retailing, Richemont and Inditex. Together, the top 10 companies by cash holdings have close to \$80 billion set aside, which is more than 40 percent of the total cash held by all listed fashion companies globally.¹⁷⁵ Additionally, internet retailers, which have seen rising demand during the Covid-19 outbreak, may leverage recent robust trading conditions to raise additional cash for acquisitions.

07. OPPORTUNISTIC INVESTMENT

Apart from fashion players, private equity funds represent a category of potential buyers with deep pockets: they were holding a record \$1.5 trillion in cash reserves at the beginning of 2020.¹⁷⁶

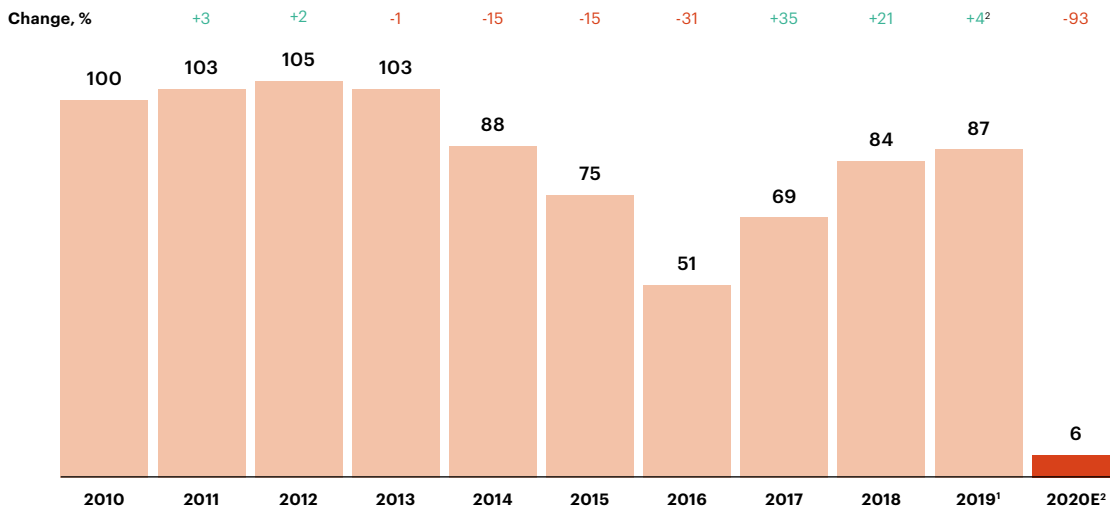
Looking ahead, we expect stronger fashion companies to expand into new categories, geographies and channels, both by capturing market share organically and by picking up distressed brands. We are also likely to see strategic hedging plays, in which brands try to insure themselves against potential shifts in consumer demand. With these plays in mind, companies should think

carefully about how they plan to integrate and embed new assets into their existing structure because this often is the determining factor of value creation from a transaction. However, buyers should also beware — distressed companies without a clear strategy or brand value are unlikely to be salvageable, even with new ownership and restructuring. Either way, we expect competition to heat up as the crisis begins to abate, so companies will need to act fast to seize the best M&A and growth opportunities out there.

Exhibit 9:

Covid-19 has devastated industry economic profit, which is forecast to drop by 93% in 2020

ECONOMIC PROFIT IN THE FASHION INDUSTRY 2010-2020, INDEXED TO 2010 EP AS 100



¹ "Normalised" industry EP growth of 4% is based on the assumption that 58 companies with Covid-effects in their 2019 result (FY19 reported in March, April or May 2020), would have had similar growth to the rest of industry if their financial year aligned with calendar year 2019. The first half 2019 results support this assumption, as 58 Covid-affected companies had EBITA growth of 10% vs. 14% in rest of industry

² Long-term Economic Profit implied by 2020 market valuations, while assuming constant debt and WACC

08. DEEPER PARTNERSHIPS

By exposing the vulnerability of procurement partners, the weakness of contracts and the risks of a concentrated supplier footprint, the crisis accelerated many of the changes that companies were already making to rebalance their supply chain. To mitigate future ruptures, fashion players should move away from transactional relationships in favour of deeper partnerships that bring greater agility and accountability.

For years, there have been calls for closer partnerships between brands and suppliers. However, progress has been frustratingly slow, evidenced by the fact that before Covid-19 the prevailing relationship between fashion companies and suppliers was transactional in nature and short-term in scope.^{177 178} Now, change is finally afoot.

As underlying tensions in the supplier relationships painfully rose to the surface during the pandemic, brands were jolted into the realisation that their supply chains need to be more resilient. A growing number of executives recognised that nurturing closer relationships is one way to do this while helping to meet their sustainability obligations and support the fashion industry's transformation to a more flexible demand-focused supply chain. In a McKinsey survey, some 73 percent of the sourcing community expected the trend towards deeper partnerships to accelerate over the coming year.¹⁷⁹

"Brands must break down and break through the adversarial bargaining that is focused on the price of finished goods out of the factory," John Thorbeck, chairman of supply chain analytics firm Chainge Capital told *The Business of Fashion* in September 2020.¹⁸⁰ "You need to collaborate and

cooperate on the components of finished goods in order to create flexibility, which in turn creates value that can be shared among the partners."

"Brands must break down and break through the adversarial bargaining that is focused on the price of finished goods out of the factory."

Amid store closures, plunging fashion sales and bankruptcies, 2020 was the year in which the fragile nature of buyer and supplier relationships was laid bare. It all began in the first few months of the year, as lockdowns in China, the world's largest producer of apparel and raw materials, caused deliveries to be delayed. This sent ripples across the globe.¹⁸¹ As a result, brands focused on China-based manufacturing scrambled to accelerate diversification strategies and then still faced capacity issues due to the dependence of many Asian sourcing markets on raw materials and textile inputs from China. As the pandemic spread around the globe, temporary lockdowns followed in other regions. Supply chains became stretched, leading larger-scale suppliers and sourcing agents with multi-country footprints to gain an advantage.

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Going forward, we expect fashion brands will seek to more permanently diversify their geographic sourcing footprint, as well as support priority suppliers with longer-term volume commitments and work more closely with them to align on strategy.

“The buying community is taking the supply chain for granted and creating long-term collateral damage. It’s very reckless behaviour.”

Later in the year, cancellations, delayed or reduced payments and contract renegotiations put a spotlight on the continuing power imbalance in the value chain. Sanjeev Bahl, founder of Vietnam-based denim manufacturer Saitex, characterised the period as a “bloodbath.”¹⁸² “The buying community is taking the supply chain for granted and creating long-term collateral damage,” he said. “It’s very reckless behaviour.”

In a McKinsey survey from April 2020, around three quarters of sourcing executives reported cancelling orders during the first wave of the pandemic, while just one in five paid for more than 75 percent of orders as agreed, and 41 percent renegotiated supplier contract terms. Not surprisingly, nearly half of sourcing executives expected many of their suppliers to face financial distress this year.¹⁸³

Examples of supply chain pressure have proliferated around the world. Italy’s artisanal luxury suppliers saw orders drop by around 40 percent early in 2020, with many avoiding furloughs only by switching to production of personal protective equipment.¹⁸⁴ In Honduras and El Salvador in Central America, apparel exports to the US tumbled by over 90 percent year-on-year in April, and in Mexico they fell by more than 65 percent.¹⁸⁵ By March, western fashion brands had reportedly cancelled \$2.8 billion of orders from

Bangladeshi suppliers, impacting the livelihoods of 1.2 million workers.¹⁸⁶ Reports in August suggested some 9 percent of Bangladeshi garment factories had closed permanently because of the pandemic, and nearly a third of the remainder doubted whether they would be able to resume normal operations.¹⁸⁷ Still, despite many factories shutting permanently, just 17 percent of fashion companies said they will co-invest in suppliers to secure future capacity.¹⁸⁸

Many brands initially reacted slowly to the impact on suppliers and workers of cancellations and payment delays, with many claiming contracts were invalidated by force majeure.¹⁸⁹ The industry response became more nuanced as the year progressed.

However, as more factories closed and public pressure mounted (supported by campaigning organisation blacklists) more brands during the northern hemisphere summer said they would indeed honour their contracts. As time progressed fashion sourcing executives put more focus on coming out of the crisis together and on strengthening the resilience of their supply chain.

By March, western fashion brands had reportedly cancelled \$2.8 billion of orders from Bangladeshi suppliers, impacting the livelihoods of 1.2 million workers.

“We have to [help build better] social protection systems... in countries where there’s a lot of production,” said Helena Helmersson,¹⁹⁰ chief executive of the H&M Group, referring to the need for “more collective, industry-wide agreements between employers, workers, unions and governments, as there are in some parts of the world. [Though] you might argue that it takes a longer time, what you’re building is a system change that will [last].”

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Though the power imbalance in the fashion supply chain is unlikely to be resolved any time soon, the voice of suppliers is getting louder, reaching consumers globally. Many suppliers are demanding a relationship based on mutual respect, fairer treatment, a reasonable share of value and better adherence to contracts. Suppliers in all industry segments are speaking up, from mass-market suppliers in Bangladesh to Indian artisans working for the international luxury houses.^{191 192} Some are threatening embargoes when brands do not pay their bills, applying rating systems and leveraging tools such as HSBC's Serai to conduct financial health checks on brands.¹⁹³ Looking forward, we expect to see more suppliers — especially the stronger ones — put their buyers' financials, payment histories and purchasing behaviours under intense scrutiny. However, most suppliers concede that brands and retailers continue to have the upper hand.

A growing number of suppliers are taking measures to compel brands to honour contracts as well as questioning payment terms and the financial risks suppliers are asked to take.

Nevertheless, a growing number of suppliers are taking measures to compel brands to honour contracts as well as questioning payment terms and the financial risks suppliers are asked to take. Some brands are responding. H&M, for example, has joined other players who isolate their labour costs and ringfence them in price negotiations in order to protect worker wages.¹⁹⁴ Meanwhile, governments are moving in that direction too, as more lawmakers around the globe look to move fashion companies away from voluntary initiatives toward taking legal responsibility for their supply chains.

As brands reinvent their supply chain relationships, they are also likely to take the opportunity to make positive moves on sustainability and human rights. Under the Paris Agreement on climate change, countries around the world are committed to trying to limit the planet's warming pathway to 1.5°C. Analysis by the Global Fashion Agenda and McKinsey shows that fashion can only play its role with a reduction in excess stock by infusing flexibility in the supply chain in close collaboration with workers. They are also increasingly partnering with suppliers across tiers, as the production and raw material stages are often the biggest emissions-savings levers.¹⁹⁵

Brands need to cater to a less predictable, multi-channel environment, enabling them to source smaller batches and react faster to in-season trends.

This year is seeing hyper-acceleration on several fronts: from sales volatility and overstock to online market share and sustainability demands by both consumers and investors. As such, there is rising pressure on fashion companies to speed up the transformation of purchasing practices and sourcing relationships. Brands need to cater to a less predictable, multi-channel environment, enabling them to source smaller batches and react faster to in-season trends. Strategic suppliers with longer-term relationships will also take on more responsibilities — including co-design and quality control — to speed up the product development process.

Some 76 percent of sourcing executives in a McKinsey survey said that the need for flexibility and speed will accelerate further in the coming year, as brands place greater emphasis on full-price sell-through and sell-out margins.¹⁹⁶ Deeper partnerships are likely to be a precondition of successful

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execution, in which suppliers have more transparency on brands' strategies, sales data and forecasts, and in which binding commitments are made to secure open-to-buy capacity.

In addition, strategic partnerships or co-investments can help suppliers invest in new machinery, semi-automation, technology and R&D. These will help companies increase productivity and optimise inventory management in a more volatile market, as well as reduce their environmental impact. We also see more players moving from broad-based sustainability visions to concrete targets and timelines to operationalise their strategies.¹⁹⁷

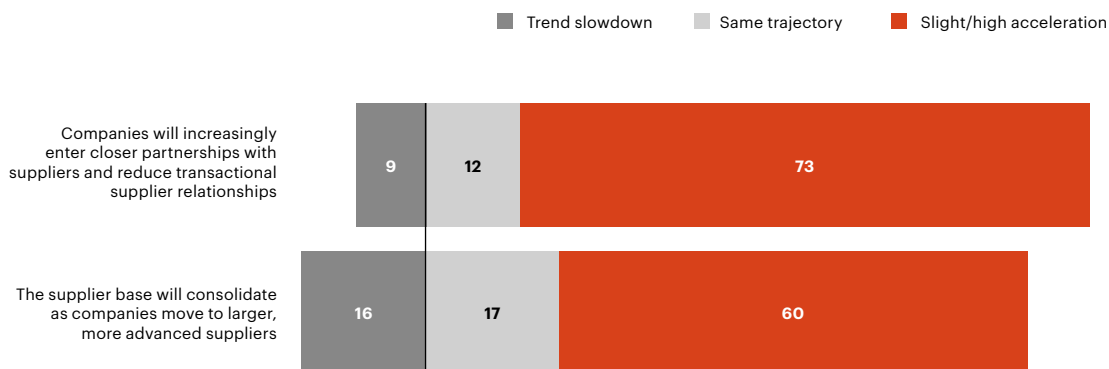
In summary, we expect fashion brands to reduce transactional or non-committal relationships in favour of medium- to longer-term

volume commitments and strategic alignment with suppliers. Empowered suppliers will likely help brands boost margins and improve consumer perceptions of the industry through increased efficiency and improved sustainability. Rather than focusing on order management, traditional negotiations and compliance, the sourcing function will play a key role in sustaining relationships and communicating with preferred partners. For digitised, agile product development, brands will also need to forge closer relationships between their design and merchandising functions and suppliers. At the margins, we will see investment in the upstream value chain. This will drive sustainability and support implementation of new technologies to boost productivity and enable on-demand manufacturing.

Exhibit 10:

Fashion executives expect to enter closer partnerships with suppliers in 2021, leading to supplier consolidation

% OF RESPONDENTS



Note: Survey respondents who answered "unsure" are not represented here

SOURCE: MCKINSEY "TIME FOR CHANGE" REPORT, APRIL 2020, FASHION SOURCING SURVEY, N=348, SOURCING STAKEHOLDERS AND FASHION SOURCING EXECUTIVES

Shahi Exports: Reforming the Fashion Supply Chain



Anant Ahuja
Head of Organisational Development,
Shahi Exports

Before the pandemic, Shahi Exports was generating roughly \$1 billion dollars a year producing for brands like Gap and Uniqlo — making it India's largest apparel manufacturer for export. The executive leading the firm's sustainability initiatives reflects on new opportunities to reform fashion's supply chain, despite the devastating impact of the crisis and more turbulence ahead.

— by Sarah Kent

When the pandemic hit western markets in March 2020, many large brands responded by cancelling orders and refusing to pay for completed goods. The impact on the supply chain was instant and, in some cases, devastating. Not only did the crisis place the livelihoods of millions of garment workers in jeopardy, it also revealed long-standing inequities in the relationship between fashion's buyers in the west and its manufacturers in sourcing hubs across the developing world. Many months later, the effects are still rippling through the supply chain. Though orders have stabilised, volumes are down significantly, and the future remains highly uncertain.

Still, amid the disruption there are opportunities to pursue exciting new business models, according to Anant Ahuja, who leads sustainability initiatives at Indian apparel manufacturing giant Shahi Exports, which produces for brands including

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Gap, Nike and Uniqlo. While the relationship between buyers and suppliers remains delicate, there are also openings to drive positive change next year.

There's been a huge amount of attention on the fact that a lot of buyers cancelled or delayed orders when the pandemic first hit. Were you surprised at how the industry reacted, and do you see a need to rewrite the relationship between suppliers and buyers going forward?

I can't really wrap my head around how some companies think that it's okay to not honour these commitments and make these payments, because the effects of that are real. People will lose their jobs, people will starve. There's going to be a lot of real suffering, not just company stocks going down. People use the word "partnership," but it's still [fundamentally] a buyer-supplier relationship, and the payment terms are what they are. [On the other hand,] if there can actually be clarity and commitment to say, "We'll give you this many orders, we'll forecast it this far ahead, and these are the things that will determine if we continue giving you orders or growing them," and [buyers] stick to that, and it's not just [based on] price or the kind of factors that they've relied on in the past, but it's more holistic, [then] I feel like that is a good step in the right direction. That seems realistic also.

Do you see things evolving in that direction at all, though? Given the pressure from consumers for brands to show they are behaving responsibly through the crisis, have you found buyers more receptive

to suggestions of improving payment terms or changing contract terms?

These conversations are tough to have and I don't think most suppliers are in that mentality yet. They're just kind of conditioned to think that this is how it is and we can work with it, work around it, whatever. Right now, the priority for a company like Shahi is to secure orders to the extent where taking orders even at really low margins was better than not having orders [at all]. I guess going forward maybe our confidence will build up, as we know that we're a reliable supplier and we should have these better kinds of arrangements.

"Overall, everyone seems to be pretty risk-averse right now. Price is still at the top of the agenda. It supersedes everything else."

More broadly speaking, what changes are you seeing in the supply chain as a result of the crisis?

[Our business heads] told me that buying patterns are returning to normal, but the turbulent times are still causing issues. [There's] 20 to 30 percent lower buying by most brands. Buyers want strategic vendors so they're consolidating their vendor base. Both on the buyer and supplier side a lot of companies are getting wiped out, so both sides are shrinking a little bit. Demand has dropped, so the tail-end suppliers have been removed from a lot of buyers' vendor lists. If you have vertical integration, the ability to make your own fabric, that's highly preferred. I think it also supports the speed and agility

that a lot of brands are looking for. Overall, everyone seems to be pretty risk-averse right now. Price is still at the top of the agenda. It supersedes everything else.

On top of the big changes you're seeing in the way the industry operates overall, what changes have you had to make internally? How do you make sure your operations are Covid-safe going forward?

The idea of social distancing in the factory is a bit foreign, but it was a lot of common, basic stuff: temperature checks, everyone's wearing masks. Most workers are young [and among] the lowest-risk category when it comes to Covid in some sense.

But for the sampling tailors, who tend to be older... we created special provisions. [For instance, we give] them a separate space in the factory [and] limit their interaction, just because of them potentially being at risk. It was an emphasis on protecting workers' health while still being able to deliver on production.

You are also a co-founder and CEO of non-profit Good Business Lab, which develops and researches the impact of worker wellbeing programmes. There's been a lot of concern throughout the pandemic over an erosion of workers' rights. In India, some states have rolled back labour laws. How are you approaching this issue as an employer at Shahi?

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At Good Business Lab we have a slogan that's "worker wellbeing is good business." We've always believed that, but now I think Covid has forced [other] people to believe it. If, for example, you don't take steps to ensure your factory is a safe working place and there's a spike in cases, you could risk having your factory shut down or people quitting. The consequences of not investing in your workers are much higher now than before, but at the same time I think a lot of sustainability programmes are harder to do. We're a big implementer of in-person training, so now we're forced to rethink how to do that because not all our factories have spaces where you could bring a cohort of people together to run a session like that.

In 2018 the Worker Rights Consortium identified serious problems at one of your factories in Bangalore. What did you learn from that and what changes did you make to avoid problems cropping up again?

That was probably our biggest crisis. We had never had to deal with that type of situation before. No one on the top management would have wanted our team members to behave in that way or to let that situation happen, but because the factories are essentially running as their own businesses, each head of a factory is almost like the CEO of the unit. Because of that decentralised approach not all the information flows to the top. It taught us a lot about the risk of this decentralised approach. Since then, we've invested a lot in building worker management communication systems, engaging with unions and being more aware about

industrial relations. As unfortunate as the situation was, it did strengthen us in a lot of ways. We used it as an opportunity to grow and learn and shift our approach. Last year I was invited to Geneva to share the case study at the UN Forum on Business and Human Rights.

"That was probably our biggest crisis... It taught us a lot about the risk of this decentralised approach."

There's clearly a lot of change and disruption in the sector at the moment. What opportunities do you see for new supply chain models in the future?

What I'm seeing that's really exciting is the idea of actually partnering with brands and retailers. [We're in conversations] with one of our biggest customers to set up manufacturing in the US together. We're a consortium of four suppliers and two brands, and the original idea was to set up an agile, small-scale manufacturing unit in the US, in Detroit, and to use it for rapid prototyping, customisation, personalisation. It's a start-up company that's supported by large firms in the industry. I feel like those types of initiatives can kind of balance things out. The other conversation we're having is with Walmart. It's hard to imagine ever being on the same playing field as them. Shahi is now a billion-dollar company and Walmart added [billions] to their top line in the last year. But Walmart is asking

interested strategic suppliers to set up units in the US. It's looking at these proposals and investing in them. That's an interesting approach where I think there's a lot more sense of partnership.

To what extent do you think that being at the forefront of these kind of innovations around sustainability and efficiency are what it's going to take to survive, and also maybe shift the power balance between buyers and suppliers?

To be honest, Shahi has reached a size now where we're actually bigger than some of our customers. Despite that, the power dynamic is still skewed towards brands and retailers because without them we don't have any orders, right? We can be as big as we want, but all the demand comes through customers, at least the way our business is right now. [Still,] it feels like Covid has in some sense revealed the brands and customers who truly value sustainability; the ones who despite the crisis are going to continue investing in it, and the ones who maybe don't as much. We've seen that our customers have become more demanding [about how we can help them achieve sustainability goals, as well as sustain quality and increase speed]. I think it's a natural progression as you become bigger and work closer with [the biggest] brands that are at the forefront of a lot of these issues. For us, what we like about working with Uniqlo and Nike and H&M is that they really do push us to innovate.

This interview has been edited and condensed.

Risk, Resilience and Rebalancing in the Apparel Value Chain

Will a heightened awareness of risk alter global sourcing strategies?

by Susan Lund and Mekala Krishnan

Key Insights

- Supply-chain shocks are happening more frequently — and are taking a serious financial toll.
- Because of its geographic footprint, the global apparel industry is particularly exposed to risks such as natural disasters, heat stress and pandemics.
- Anywhere from one-third to one-half of global apparel exports could shift to different countries in the next five years as companies alter their sourcing strategies in an attempt to increase supply chain resilience.

Much has been written about how to make supply chains more resilient.¹⁹⁸ But many companies, wary of eroding efficiency, have spent recent years putting off the preventive measures that could minimise the impact of future disruptions.

Today, the pandemic has once again driven home the urgency of managing operational and supply-chain risk. While every goods-producing sector is confronting this challenge, the apparel industry stands out as one of the most heavily exposed. Factories are not only coping with workplace health and safety issues. They also face financial distress from orders drying up as falling consumer demand hits fashion brands and retailers worldwide.

The current crisis underscores the fact that the unexpected now has to be considered probable. To cope with eventualities, companies need to embed at least a baseline level of losses from disruption into their financial planning. This information can help global apparel brands and retailers make better decisions about how

to invest in supply-chain stability and prepare themselves to better withstand future disruptions.

Disruptions Are Growing More Frequent and Severe

It's not just a figment of our collective anxiety: the world really has become riskier. Changes in the environment and in the global economy are increasing the frequency and magnitude of supply-chain shocks. Dozens of weather disasters each year cause damages exceeding a billion dollars each — and the economic toll caused by the most extreme events has been escalating.¹⁹⁹ A world of shifting geopolitics is producing more trade disputes, tariffs and uncertainty. Interconnected supply chains and global flows of data, finance and people offer more “surface area” for risk to penetrate. Ripple effects can travel rapidly across these network structures — and across national borders.

McKinsey surveyed dozens of supply chain

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experts in mid-2020 to gauge just how frequently things go wrong. Their responses were surprising: Manufacturers can expect disruptions lasting one to two months to occur every 3.7 years on average, and those dragging on for two months or longer happen roughly every five years. Lean global supply chains deliver real margin improvements, but frequent disruptions have to be fully accounted for as a real cost of doing business with this kind of structure.

Companies are attuned to some types of risk simply because they encounter them more often. Data breaches, theft and industrial accidents happen. Trade disputes dominate the headlines. Most multinationals have systems and functions in place to try to prevent these types of incidents or to respond to them quickly.

But some types of shocks are not on the typical company's radar. They may be rare occurrences, but they can inflict much bigger losses. These include extreme weather, earthquakes, financial crises, major terrorist attacks and, yes, pandemics. If 2020 has taught us anything, it's the folly of assuming that extreme scenarios will never come to pass.

Lean global supply chains deliver real margin improvements, but frequent disruptions have to be fully accounted for as a real cost of doing business with this kind of structure.

We analysed a wide range of industries to assess their exposure to specific types of shocks. Out of the 23 value chains analysed, apparel emerged with the second-highest level of exposure (topped only by communication equipment; see Exhibit 11). The labour-intensive nature of the apparel value chain, as well as its geographic footprint, makes it particularly exposed. In the current pandemic (as well as any that might occur in the future), apparel manufacturing is susceptible to shutdowns because of this and unpredictable

drops in consumer demand. Furthermore, a large share of apparel exports come from Bangladesh and Vietnam, which are subject to heat stress and flooding. The industry as a whole is also exposed to workplace risks — a painful reality brought home by the 2013 Rana Plaza collapse in Bangladesh, which killed more than 1,100 garment factory workers and injured thousands more. This tragic disaster spurred the industry toward more active supply chain management and transparency about working conditions. But more can be done.

Over the Course of a Decade, Companies Can Expect Disruptions to Erase Half a Year's Worth of Profits at a Minimum

Supply-chain shocks can have significant financial consequences. We built representative income statements and balance sheets for hypothetical companies in 13 different industries, using actual data from the 25 largest public companies in each. We then put them through a stress-test to see what kind of financial losses a 100-day shutdown would produce.

Our scenarios show that, over the course of a decade, companies in most industries can expect a single production shock lasting 100 days to wipe out between 30 and 50 percent of one year's EBITDA.²⁰⁰ For the average textiles and apparel company, that number is about 40 percent. An event that also disrupts distribution channels would push the losses sharply higher in some industries. The magnitude of financial loss depends on whether a company holds enough inventory to get it through the period of interrupted production, as well as whether it has the ability to ramp costs up and down. Most inventory of finished goods in the apparel industry is held by retailers, which means that production shutdowns could significantly impact manufacturers' profits.

These are the hidden and recurring costs of doing business with complex supply chains in a riskier world — and they are only the baseline. Estimating these costs allows companies to better understand how much they can expect to invest in resilience and still see a long-term pay-off.

Will Value Chains Shift Across Countries?

Today, much of the discussion about resilience involves questioning where things are made, considering lower-risk locations and reducing the geographic breadth of supply chains to make them easier to manage. But the interconnected nature of value chains limits the economic case for making large-scale changes in their physical location. We estimated what share of global exports could move to different countries based on the business case and how much might move due to policy interventions. To consider whether economic factors would support a geography shift, we looked at whether movement is already underway, how knowledge- and capital-intensive the value chain is, how tied it is to geology and natural resources, and the degree to which it is already regionalised. We also considered non-economic factors, such as importance to natural security, competitiveness and self-sufficiency.

As China's exports have plateaued, more apparel manufacturing for export has moved to places such as Bangladesh and Vietnam.

Apparel stands out as one of the industries with the largest share of total exports that could potentially move to different countries (36 to 57 percent in apparel, as well as 23 to 45 percent in textiles). Supply chains are already evolving in these highly traded, labour-intensive industries. China has long been the world's dominant maker, and it still accounts for some 29 percent of apparel sold globally. But the country's wages are rising, and Chinese producers can now focus on meeting domestic demand. In 2005, China exported 71 percent of the finished apparel goods it produced. By 2018, that share was just 29 percent. While some apparel production may nearshore to US and EU markets, most would likely shift to Southeast Asian countries due to their comparative advantage in labour and overhead costs. As China's exports have plateaued, more apparel manufacturing for

export has moved to places such as Bangladesh and Vietnam. Turkey has become a major producer of clothing that is exported to Europe. Newer hubs such as Cambodia, Ethiopia and Honduras are also beginning to emerge. But companies that begin sourcing from these and other developing economies will need to understand and safeguard against a wide range of risk, from natural disasters to future pandemics.

Will a New-Found Appreciation For Risk Prod Companies to Act?

The need to make supply chains more transparent and resilient has been widely discussed for years. But most strategies for doing so require making long-term investments or accepting a slightly higher cost of goods. For that reason, only a small group of leading companies have taken decisive action.

However, this time really might be different. Companies are considering a range of resilience measures — and most of them do not involve finding new suppliers in different locations. They can opt to hold more inventory, build redundancies into transportation and logistics, reconfigure factories and warehouses to withstand natural disasters and develop the ability to flex production across multiple sites. For example, Esquel, a supplier to brands such as Hugo Boss and Nike, found itself unable to export fabric from Mainland China to its factories in Vietnam during the initial Covid-19 outbreak. But the company activated its back-up plan and pivoted to shipping through Hong Kong to keep production going.²⁰¹

Companies not only have a renewed sense of urgency about addressing risk; they also have a new way forward. The pandemic has occurred at a moment when manufacturing technologies are leapfrogging forward. Particularly when compared to other manufacturing industries, apparel production has a great deal of room to digitise and reap the benefits.

In our experience, creating supply chain transparency through digitisation can boost both productivity and resilience. It is critical to gain

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visibility into who supplies your suppliers and spot any vulnerabilities hidden deep in the lower tiers of the network. When the Covid-19 pandemic broke out, Nike’s digitised supply chain enabled the company to quickly shift products headed for brick-and-mortar stores to e-commerce fulfilment centres in China. As a result, it minimised the hit to revenue.²⁰²

Some companies have made it a point to model prioritised risks, but they have often done so by looking at these shocks as discrete rather than cascading events. Now, analytics tools enable a more sophisticated approach that quantifies broader and more integrated scenarios. This makes it possible to look not only at extreme one-off events but also at their knock-on effects and the ongoing business

cycle, taking correlations into account. Scenarios can also incorporate a range of risk-mitigation strategies to test which would be most effective. The results can then inform strategic planning and capital allocation decisions.

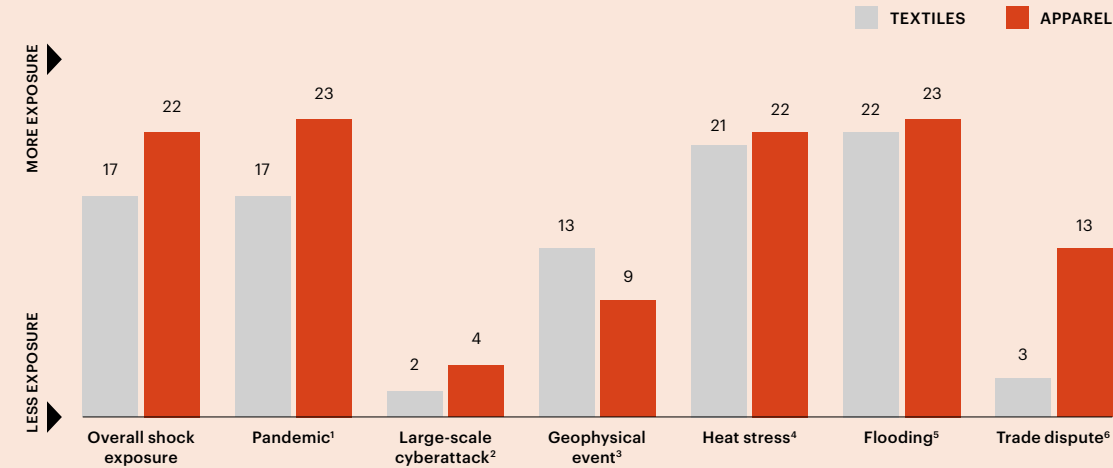
Preparing for future hypotheticals has a present-day cost. But if those investments focus on digitally connecting the entire value chain from end to end, they can pay off over time — not only minimising future losses but boosting productivity and strengthening entire industry ecosystems today.

This article draws on a larger body of research on trade and global flows from the McKinsey Global Institute, the business and economics research arm of McKinsey & Company. The latest report in this series is Risk, Resilience and Rebalancing in Global Value Chains. The authors would like to thank Kyle Hutzler and Dhiraj Kumar for their contribution to this article.

Exhibit 11:

Apparel is one of the value chains most exposed to shocks, with textiles not far behind

RANK OF EXPOSURE TO SHOCKS OUT OF 23 VALUE CHAINS, 23 = MOST EXPOSED TO SHOCKS



1 Based on geographic footprint in areas with high incidence of epidemics and high people inflows. Also considers labour intensity and demand impact. Sources: INFORM; UN Comtrade; UN World Tourism Organization; US BEA; World Input-Output Database (WIOD).
 2 Based on knowledge intensity, capital intensity, degree of digitisation, and presence in geographies with high cross-border data flows. Sources: MGI Digitization Index; MGI LaborCube; Telegeography; US BLS.
 3 Based on capital intensity and footprint in geographies prone to natural disasters. Sources: INFORM; UN Comtrade; WIOD.
 4 Based on footprint in geographies prone to heat and humidity, labour intensity, and relative share of outdoor work. Sources: MGI Workability Index; O*Net; UN Comtrade; US BLS.
 5 Based on footprint in geographies vulnerable to flooding. Sources: UN Comtrade; World Resources Institute.
 6 Based on trade intensity (exports as a share of gross output) and product complexity, a proxy for substitutability and national security relevance. Sources: Observatory of Economic Complexity; UN Comtrade.
 NOTE: OVERALL EXPOSURE AVERAGES THE SIX ASSESSED SHOCKS, UNWEIGHTED BY RELATIVE SEVERITY. CHART CONSIDERS EXPOSURE BUT NOT MITIGATION ACTIONS. DEMAND EFFECTS INCLUDED ONLY FOR PANDEMICS.

SOURCE: “RISK, RESILIENCE AND REBALANCING IN GLOBAL VALUE CHAINS”, MCKINSEY GLOBAL INSTITUTE, AUGUST 2020

09. RETAIL ROI

Physical retail has been in a downward spiral for years and the number of permanent store closures will continue to rise in the post-pandemic period, compelling fashion players to rethink their retail footprints. Amplified by a potential power shift from landlords to retailers and the need to seamlessly embed digital, companies will need to make tough choices to improve ROI at store level.

For those who dismissed the “retail apocalypse” as an exaggeration, 2020 will be remembered as the year that gave them food for thought. In the US alone, some 20,000 to 25,000 stores are likely to shut this year, which is more than double the number in 2019.²⁰³ Even retailers that actively addressed the retail disruptions of recent years have been forced to reduce their store network significantly. Macy’s, Zara, J.C. Penney, John Lewis, Onuma and Isetan Mitsukoshi are among those to have announced closures around the world. One exception to the rule is China, where, according to McKinsey Fashion Scenarios (based on information available September 2020), the offline market is expected to grow by up to 5 percent in 2021 versus 2019, in the Earlier Recovery scenario. However, Europe is likely to see an 8 to 13 percent decline in offline sales and the US will likely see a drop of 22 to 27 percent compared to 2019 levels.²⁰⁴

The pandemic is, of course, the predominant recent source of stress for physical retail, but there are also significant long-term challenges, including sometimes punitive operating costs. Rent alone can often account for 25 to 40 percent of operational expenses in the physical space.²⁰⁵ In times of crisis,

these fixed costs quickly become disproportionate to revenues, leaving retailers with limited options to reduce the cost base in the short term.

Many retailers have embarked on strategic reviews of their store networks and launched initiatives to improve the productivity of remaining stores, leveraging digitisation, automation and more flexible working practices. With respect to the latter, they are both cutting staff costs to align with lower turnover and training staff across diverse skill sets. These kinds of decisions are often accompanied by budget and capital reallocations across channels to better reflect revenue potential. Digital is often the beneficiary.

Rent alone can often account for 25 to 40 percent of operational expenses in the physical space.

According to the BoF-McKinsey State of Fashion 2021 Survey, 37 percent of fashion executives expect to close more than 10 percent of their stores by the end of 2021, compared with pre-Covid plans. Zara’s owner Inditex has announced it will close up to 1,200 stores over two

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years and invest €2.7 billion (approximately \$3.2 billion) in digital transformation and online-offline integration.²⁰⁶ Nike has promised to accelerate its digital strategy and invest in high-potential areas, which it said would lead to job cuts in stores and new jobs in digital.²⁰⁷ Similarly, some executives in Asia-Pacific markets are focusing on increasing online sales capacity rather than investing more in physical retail (see Exhibit 12).

The role of in-store employees is evolving, as companies retrain or redeploy people to add a human touch to digital experiences — and vice versa. For years, futurists have predicted these so-called “bionic” retail services across a variety of sectors. Now the conditions are right for the idea to become a reality. The ultimate goal is to deliver a stimulating and rewarding shopping experience that caters to individual needs across channels. We expect these kinds of hybrid roles to increase exponentially, with in-store employees requiring high levels of skill to help deliver an omnichannel offering. Activewear brand Fabletics is among the companies that are responding, experimenting with “omni-associates” who both guide clients in-store and interact through online channels.^{208 209}

“The lesson... for all brands is that we don’t build our lives around retail. Retail builds itself around our lives,” wrote retail industry futurist Doug Stephens in a column on *The Business of Fashion*.²¹⁰

“The lesson for all brands is that we don’t build our lives around retail. Retail builds itself around our lives.”

With store closures expected to accelerate in 2021, there is a growing sense that landlords have more to lose than tenants, leading to the potential for a relative power shift in the relationship.

As a result, while some real estate firms are taking retailers to court, others are considering a possible transformation of lease models. New Look and All Saints are among tenants to have requested

turnover-based rents for their stores, while some landlords are experimenting with rent models indexed to store performance, alternatives to upward-only rent reviews and lease renewals with shorter terms.^{211 212}

“[Currently luxury] e-commerce is used as a complement to flagship stores, not a substitute. In the future [however], this trend will be reversed and physical stores will be a complementary experience to e-commerce.”

To gauge the ROI of their retail networks, some brands are using new key performance indicators that measure the stores’ contribution to omnichannel profitability. Through this lens, the ROI of a flagship store is often considerably higher than it would appear to be. Alongside this trend, a number of companies have invested in hybrid flagship spaces, tapping demand for digitisation, localisation and personalisation. Burberry, Nike and digitally native Arias have recently invested in hybrid flagship spaces.²¹³ Nike’s latest House of Innovation store opened in Paris in July. The format deploys technologies such as apps and body scans to create a richer shopping experience and leverages data analytics to predict footfall and sales patterns.²¹⁴ Burberry’s boutique in Shenzhen, China, offers a customised WeChat programme in partnership with Tencent, which delivers to customers exclusive content, rewards and personalised experiences.²¹⁵

“[Currently, luxury] e-commerce is used as a complement to flagship stores, not a substitute. In the future [however], this trend will be reversed and physical stores will be a complementary experience to e-commerce,” said Li Rixue, chairman and chief executive of Chinese luxury e-commerce company Secoo.²¹⁶

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New store formats will continue to emerge in 2021, offering a range of omnichannel services, such as BOPIS (buy online pick up in store) adapted for in-store returns, in-store ordering and customisation. Among recent examples of innovative initiatives, French footwear brand Veja has opened a “services” concept store in Bordeaux that features a shoe-repair corner, and Brazilian luxury mall group JHSF Participações allows customers to remotely chat and browse with in-store personal shoppers via WhatsApp and receive their purchases at home.²¹⁷ “We are increasingly reinforcing the idea that the shopping centre can also go to the customer, wherever they are,” said Thiago Alonso de Oliveira, JHSF Participações’ chief executive.²¹⁸

Another way to improve store ROI is to convert strategically located but underperforming (or closed) stores into digital fulfilment centres, following examples from other retail segments. In April, Bed, Bath and Beyond in the US said it was converting a quarter of its locations into dark stores.²¹⁹ At the height of the pandemic, players experimented with repurposing closed stores as warehouses. US department store Nordstrom, for instance, rapidly increased the share of online orders handled by its full-price stores and its off-price Nordstrom Rack stores, which were both closed to the public at the time, in order to reduce inventory levels.²²⁰

For some players, these temporary strategies could become permanent as online order volumes continue to grow.²²¹ At the same time, as retail localisation trends evolve, we are likely to see increasing numbers of small stores, enhanced with hand-picked inventories, and neighbourhood stores designed to forge local connections, as seen with Macy’s and Harrods’ experiments with smaller, out-of-town formats.^{222 223} The relative importance of these new formats compared to large downtown stores will be a factor of how long the health crisis continues to restrict movement and of how long consumer preferences for local retail endures after that.

In addition to the repurposing of entire stores, brands will trial new uses for parts of their retail floorspace, moving beyond co-retailing to alternative models such as space sharing. French sports retailer Decathlon, for example, has opened boutiques in stores of grocery chain Franprix.²²⁴ The move reflects the growth of retail-as-a-service models, in which businesses lease out space to generate revenue and boost footfall. In the US, Neighborhood Goods and Showfield are prime examples.²²⁵

Some brands and retailers are capitalising on demand for independent workspaces, creating blurred boundaries between work and leisure by opening up retail floorspace to remote working.

Some brands and retailers are capitalising on demand for independent workspaces, creating blurred boundaries between work and leisure by opening up retail floorspace to remote working. Selfridges and Westfield London are among those to have announced plans.^{226 227}

As companies aim to boost store ROI in 2021, many will focus their store footprint on high-growth markets. Brands including Montblanc, Hublot and MSGM are targeting Asia for new store openings, reflecting the region’s economic growth potential and the fact that China is ahead of the global recovery curve (see Mapping the Retail Portfolio of the Future on page 89).²²⁸ Still, a precondition of success in the region is likely to be the ability to offer a mature digital-physical hybrid, reflecting Chinese consumers’ high levels of digital engagement. Uniqlo is among the brands with major plans, having reaffirmed in March 2020 its pre-pandemic announcement that it would open 80 to 100 new stores in the market next year.²²⁹

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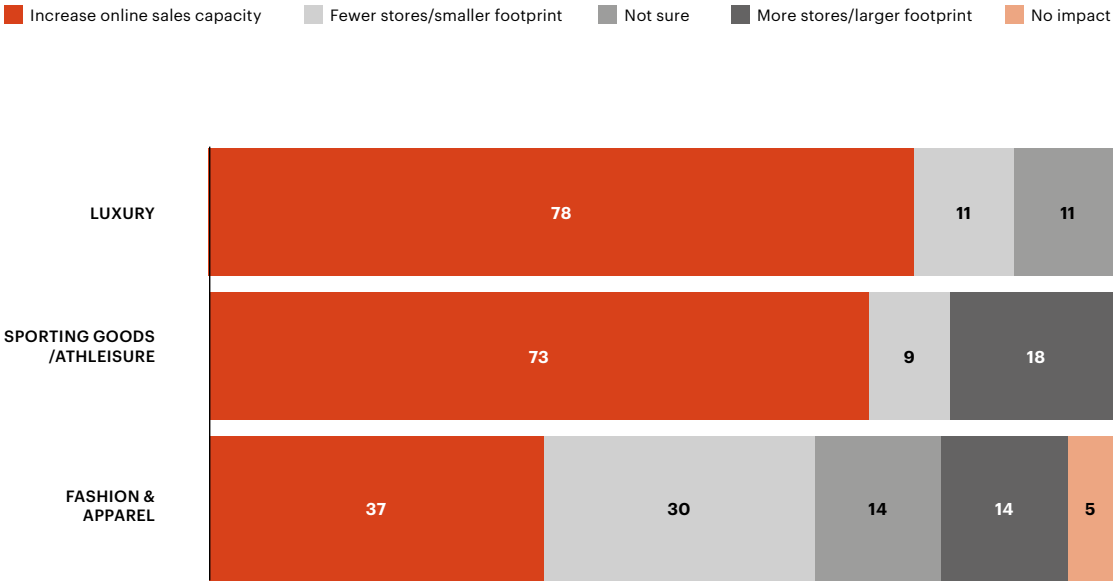
In 2021, fashion leaders must finally resolve long-standing structural issues, closing unproductive stores and renegotiating rent terms across their portfolios. The challenging real estate landscape will create opportunities to engage landlords in conversations about ways to improve productivity, both overall and at individual sites. At the same time, executives should evaluate their presence in fast-growing regions such as China to optimise retail strategies to capture market growth.

While spearheading the many changes to the store footprint and function, fashion executives will also need to develop new models to measure store ROI. Fundamental to these will be their alignment with emerging ideas about store economics and use of data to make every square metre generate as much value for the omnichannel model as possible.

Exhibit 12:

APAC fashion executives are expecting to increase online sales capacity and reduce their footprint in response to Covid-19

% OF RESPONDENTS, EXPECTED SALES NETWORK IMPACT FROM COVID-19, MAY 2020



SOURCE: CBRE APAC RETAIL FLASH SURVEY, MAY 2020

H&M Group: Making Retail More Resilient



Helena Helmersson
Chief Executive, H&M Group

H&M Group sank to a loss in the second quarter of 2020 as the pandemic caused sales to plummet 50 percent year-on-year, but it has since recovered faster than expected. The fast fashion giant's chief is focusing on more sustainable business models to drive growth in the coming years.

— by Imran Amed and Tamison O'Connor

When Helena Helmersson stepped into the top job at H&M Group in January 2020, fast fashion was already under pressure, facing disruption from ultra-fast digital native competitors and growing scrutiny for chasing unbridled growth amid a climate crisis. The pandemic forced leaders like Helmersson to find ways to adjust to the many disruptions and constraints that came with the crisis. Some retailers were forced into bankruptcy; others cancelled next season's orders, leaving their suppliers in the lurch, even as pressure to answer for the social and environmental impact of business decisions continued to mount.

H&M was one of a few major retailers to pay garment suppliers for orders already produced or in progress. While Helmersson

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managed to return the group to profitability faster than expected, H&M's future success will hinge on whether the company can finally crack omnichannel retail and scale up sustainable business models while still generating growth and profit.

There are so many things that have changed because of the coronavirus crisis. As you think about the future of the H&M Group in the context of the future of fashion and retail, which of the current changes do you think will become permanent changes?

The most clear [change] is that customers that had not yet started to do their shopping online have now started to do so. We didn't know [if] people [would] go back to their old behaviours, but what is now really clear when we re-open the stores [is that people] really want to meet us in both channels, physical stores and online. They want to do both. In the future probably there's even more channels than our two main ones.

E-commerce efforts at H&M haven't always been successful. What have you learned about how to make that model work in the future?

The key is speed and flexibility. So, for example, to cope with a crisis like this we had to move a lot of garments between the channels, which sounds pretty basic, but it was a lot of work doing that with such big volumes. Also, it is about speed and flexibility when it comes to customer-facing [initiatives]. For example, if [customers] want to meet us online or in stores... we need to make sure that there is a customer experience that is integrated, in the sense that whether you choose to go to a store or online, it's the same experience,

and who we are as a brand should be really, really clear.

What's your thinking now on store footprint and how that will have to adapt to this new environment? What will an optimised retail footprint for a brand like H&M look like going forward?

We will have different formats when it comes to stores, depending on whether it's a big city or a small city, and [we] will have to look at what kind of role a particular store contributes. For example, should it be a source of inspiration? Should it be an experience? Should it be part of the supply chain, or value chain, or should it be for families? Should it be for tourists? It's about looking at the customers and their needs, like how should we work with local relevance, for example. I'm truly excited about pursuing that work. In some countries it will have to mean that we do more closures. In some countries it will be that we can keep on expanding because we don't have the hubs that we want.

Before the pandemic you had around 5,000 stores in over 70 countries but now you're projecting net store closures of around 250 stores. Historically, fashion brands tended to just open lots of stores because it was the one sure-fire way of growing revenue. When you're shrinking the footprint, what will be the impact on your top line?

We are in a transition period now. We come from a place where we used to only have our physical stores, and then we introduced online gradually. So, [as we] transition towards omni-channel, exactly what that means [for the] top line is very, very hard to predict. We have to make sure that

we make the transition in a profitable and sustainable way so that in the long-term [we] can continue growing.

So as you consider the outlook for 2021, are you feeling confident that the business will return to growth vis-à-vis where we were before the crisis?

It's impossible to predict the growth. We're going to continue growing, of course, but how fast will the customer traffic come back? I guess it's as hard for me to predict as for you. That's why we are working on changing our processes to become faster, to become more flexible... that's what will make us come out of this even stronger. And from what we can see, especially in Europe, the demand for sustainable products and value-for-money products will be there to a greater extent.

Yes, but the most sceptical customers out there will say fast fashion and sustainability are inherently contradictory terms. You're so passionate about sustainability, but you work in a company that creates millions and millions of garments every year. How do you reconcile that?

I am so sad that we have let the word fast fashion become something negative. The fact that the younger generation want to dress themselves in a way that shows their personality and express themselves in different ways, that used to be something really beautiful. Now, because of the system behind it, it has become something that people talk about in a negative way. It's the system behind it that is broken, and that's where I see that we have such a big responsibility to change it. The pace we've had the

09. RETAIL ROI

last decade cannot be the pace that we have in the coming decade. We have to speed up changing the system [in terms of sustainability] so that people can continue to express themselves through fashion and design.

What are the main areas you are focusing on to change the system?

One, produce what we can sell. That's where you also need tech as an enabler to get to that point. Two, it's about sustainable products, and of course, you want to make that circular. We really have to speed this up so that we get fibres back in the system again and again and again. Three, I think it's about new revenue streams that are circular in themselves, or at least contributing to becoming climate-neutral, and then climate-positive, going towards the vision of becoming fully circular. You can look at rentals, remake and resell. We have to find quickly what can we scale up faster than others. And of course, you also need to make sure that it's profitable, because otherwise it's not sustainable. So how do you make sure you can scale it up and that after a while it can become profitable? Here it's more on the big players to find new start-ups and new technologies, and be part of supporting that, because we have resources to do so.

The people who have been hit hardest by this crisis are garment workers in low-cost production countries like Bangladesh. What happens to these workers? You want to protect their jobs, but some of them are already out of work and they have nothing.

We have a joint responsibility to look at this holistically and understand that economic growth helps people, in the sense that it

can bring them out of poverty... It's about building resilient systems in these markets. If I look at it in Sweden, you have a whole social protection network where if you lose your job you still have a system there to rely on, at least for a while until you find another job. In countries where there's a lot of production, it's not the same kind of system, so we have to work with governments and the ILO [International Labour Organization]. We have to work with unions so that workers always have a voice, and so that they can go to their employer to negotiate and to really have that kind of social dialogue that is so important and that they have someone to turn to. We have to [help] build social protection systems in those countries.

“It’s the system behind it that is broken, and that’s where I see that we have such a big responsibility to change it. The pace we’ve had the last decade cannot be the pace that we have in the coming decade.”

H&M has made commitments around living wages in the supply chain for a long time, but this is still not being achieved. What is getting in the way?

First of all, what we have done has definitely made a difference. We see a positive tendency, but I couldn't say that salaries are high enough. In a dream world, it would be fantastic if you could see more collective agreements, industry-wide agreements between employers, between workers, unions, governments, as there are in some parts of the world. It's all about making industrial relations work in a better way. It takes

a longer time, but what you're building is a systemic change that will sustain. There are a lot of things that we do here and now, but in parallel with that it's really important to collaborate with others to try to move the needle when it comes to the systems in those countries.

You mentioned some of the new models you've been experimenting with such as rental and resale. What are the early results from these and how do you take little experiments and actually make them big enough so that they have real impact?

It's challenging. That's one of the parts that stresses me a bit with [our] circular vision and how to speed it up, because it's quite easy

to do smaller tests, but scaling it is what will actually have an impact. Our take has been to do a lot of things in parallel. We need to try rentals, try remake, and try resale. [But], we don't have much time in [this] exploration phase. We need to have courage, we need to have more knowledge, and we simply need to find those ways going forward. If you look at the number of initiatives we are doing, it's amazing, but to scale those up, that's the nut we have to crack.

This interview has been edited and condensed.



Mapping the Retail Portfolio of the Future

In the post-pandemic world, conventional approaches to store network optimisation are no longer enough. Fashion brands need to urgently scrutinise their global retail footprint or risk further financial blows in 2021.

by Casey Hall

Key Insights

- Retailers will review each location and consider radical changes based on the store's new purpose in the post-pandemic era.
- The year ahead will be one of strong consolidation of retail spaces, particularly those in overstored markets like the US.
- With the repatriation of Chinese luxury spend, there are opportunities to expand offline retail in key mainland cities.

There is no doubt that the year ahead will be one that is enormously difficult to navigate and plan for. But for fashion brands that are highly exposed to physical retail, Covid-19 provides the impetus they have long needed to chart a new course for their store network — one that experts say must be a sprint, not a marathon.

With store inventories and real estate costs weighing heavily on their cost base, fashion retailers have been in a race to capture e-commerce spend as consumers' uptake of the channel skyrocketed during the pandemic. But no matter how sophisticated and seamlessly integrated their digital strategies are, omnichannel won't resolve a bigger issue that many players face in the run-up to 2021: Most global store footprints are no longer the right size, shape or scope for the times in which we live. More to the point, the tool that companies have traditionally used to fix that problem — store network optimisation — now needs a major rethink too. So much so that some commercial real estate experts have begun to encourage retail clients to examine their global store portfolio as though it doesn't already exist.

“We almost do a brand-new market entry strategy,” said Charlotte Elstob, Vice President of International Retail at JLL, who asks brands to consider how they would position themselves and locate stores — and at which size and format — if they were to re-enter each market from scratch.

Global store footprints are no longer the right size, shape or scope for the times in which we live.

Nothing is taken for granted in this kind of approach; no locations are sacred, and no store is given a free pass. Indeed, every store is put under the microscope using key performance indicators that go far beyond conventional four-wall analysis. Store profiles and locations are then scrutinised in the context of the retailer's global, regional, national and city footprints.

“Taking into account the sector of retail, [we're asking fundamental questions again like] whether you need to be close to transport hubs, or

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a more organic footfall residential neighbourhood, or whether you [really] need to have a site on what has been historically one of the busiest and most prominent streets in that city,” she added.

The answers to these questions will, of course, differ by brand and — given the pace of change in the industry — many of the considerations that are relevant now may be different in 2021. With disruptions and uncertainty likely to be constant in the year ahead, how can global fashion brands practically map out their retail portfolio for the future?

Adapt Retail Spaces for Post-Pandemic Purpose

Traditionally, the return on investment of a retail store was measured in terms of how much product was sold within the four walls of that physical space. But when a growing percentage of sales occurs online or through omnichannel strategies, that calculation no longer adds up.

Instead, according to retail futurist Doug Stephens, retailers should think of physical store investments as they have traditionally considered media investments — as a vehicle for customer acquisition, rather than purely as a distribution venue for product.

“We need to determine what the value of an impression in a physical store is,” Stephens said, much like we have determined a market value for views and clicks in the digital space. “Then you wind up with: here are the four-wall sales, here’s what we can reasonably attribute to that store in terms of online sales and here’s the media value we can attribute to that store, and that gives you a full picture of what a store is worth.”

Far from diminishing the role of the physical store network, online shopping can actually elevate the importance of some physical stores. This trend has already become apparent in Asia, particularly in China, where “New Retail” (a term coined by Alibaba founder Jack Ma back in 2016 to describe the seamless merging of retail’s online, offline and logistics arms) has seen the integration of digital into all manner of offline store experiences.

At Intime, a department store chain

taken private by Alibaba in 2017 which is at the forefront of the Chinese tech giant’s “New Retail” experiments, the store’s Miaojie app not only promises two-hour delivery for local consumers, it also tracks stock on shelves and in storage in real time, allowing merchants to adjust supply and pricing swiftly.

Far from diminishing the role of the physical store network, online shopping can actually elevate the importance of some physical stores.

Physical stores such as this are acting as hubs of discovery, places for entertainment and gathering and, increasingly, as fulfilment centres. Even before the pandemic, a significant number of under-performing retail outlets were converted to fulfilment centres. A CBRE study from 2019 found that, in the US, 7.9 million square feet of retail space had been turned into 10.9 million square feet of new industrial space (mainly warehouses and e-commerce distribution centres) since 2016. Covid-19 has only accelerated this shift.

Major US retail players like Walmart, Kohl’s and Target have been working to convert their retail spaces into mini distribution hubs to shorten the last mile for customers. In other markets, physical retailers are swiftly reimagining and repurposing their valuable real estate assets, including those in markets that had less-developed e-commerce infrastructure and lower rates of internet penetration prior to the pandemic.

According to Thiago Alonso de Oliveira, chief executive of JHSF Participações, the parent company of luxury retailer Cidade Jardim in São Paulo and several other upmarket shopping malls across Brazil, the firm’s revamped online platform CJ Fashion has helped temporarily transform their malls into de facto fulfilment centres for wealthy clients ordering by WhatsApp. “It’s more like a marketplace [as] our data is integrated to the inventory of the physical stores, so we know

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in real-time what products are available in which sizes, and so on.”

Physical stores in this context become hybrid shopping destinations, community-building centres (for consumers) and logistics and distribution centres (for brands) — a combination of duties that is unlikely to fade even after the Covid-19 emergency subsides. One reason for this is the trust that some legacy retailers have built with their clients over generations. “For brands, it feels safer to be with us,” said Juan Carlos Escribano, chief executive of El Palacio de Hierro, a department store chain in Mexico that has been in business for over 130 years and serves as a shop-in-shop location for major luxury brands.

Physical stores act as hubs of discovery, places for entertainment and gathering and, increasingly, as fulfilment centres.

While some department stores and shopping centres will continue to serve an important role in brands’ overall retail network as anchors for concessions and other formats, the locations for future large-scale developments could be very different if footfall in city centres does not return to close to pre-pandemic levels.

Consolidate in Most Markets Except in China

Nowhere will the store footprint change more than in the rebalancing of store numbers and locations across the world, as some markets prove to be more resilient than others. In 2021, Europe is likely to see an 8 to 13 percent decline in offline sales and the US will likely see a drop of 22 to 27 percent, compared to 2019 levels.²³⁰

This suggests that store networks in these regions will need to be significantly reduced. Retail consolidation has been happening in the US and other mature markets for years, but the crisis amplified the sense of oversupply. As Doug Stephens bluntly puts it: “The US market could literally shed 50 percent of its physical assets... they are [so]

over-saddled with physical retail.”

The one notable exception to the inevitable cull of physical retail is China, where the offline market is expected to grow by up to 5 percent in 2021, compared to 2019 levels. Here, some brands will actually need to expand their footprint to meet surging domestic demand spurred on by the pandemic.

Indeed, as travel retail and outlet centres in Europe are starved of all-important Chinese consumers, and where travel restrictions (alongside geo-political strife) have decimated destinations once favoured by mainland shoppers like Hong Kong, new hubs such as Sanya and Haikou on the southern Chinese island of Hainan are attracting investment.²³¹ In October 2020, Chinese department store operator Youa announced a 1 billion yuan (\$148 million) investment to further improve the island’s luxury offering,²³² creating even greater interest in the cluster of resorts located there for conglomerates like LVMH, Kering and Richemont.

Indeed, one of the biggest retail stories of 2020, particularly for luxury, has been the repatriation of Chinese spend as the sector’s most important consumer group stayed home and, as such, there is now an even greater imperative for brands to re-balance their mainland store networks against their global footprint. Store numbers for top luxury brands in China rose 4 percent in the first half of 2020, while those for cosmetics brands jumped 8 percent, according to a report by property consultancy Savills.

The one notable exception to the inevitable cull of physical retail is China, where the offline market is expected to grow by up to 5 percent in 2021, compared to 2019 levels.

One notable addition to China’s luxury scene will be Harrods’ first outpost, which is scheduled to open in Shanghai in late 2020. Rather

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than follow the ambitious roll-out strategies of international competitors like Galeries Lafayette, Harrods will open a format called The Residence, which is more akin to a private members' club than a traditional store. Though plans for this were in the works prior to the pandemic, it highlights the need for global brands and retailers to reconsider how they serve their consumers by fostering community in a physical space.

According to Josh Gardner, chief executive of Beijing-based Kung Fu Data, the good news for those looking to increase their physical retail presence in China is that there are fantastic deals to be had in the current climate.

"It's now cheaper to convert offline in China than it is to convert online," he said, referencing the skyrocketing costs of customer acquisition on the major e-commerce platforms that international retailers use to penetrate the Chinese market. "Chinese landlords will take rent share, so you can activate your brand almost instantly through their networks. Everyone is just looking for business."

"It's now cheaper to convert offline in China than it is to convert online."

Brands should, however, approach expansion with caution. At the luxury end of the spectrum, retailers have been burned in the past by over-ambitious physical retail rollouts across China. After a slowdown in spending attributed to Chinese President Xi Jinping's crackdown on corruption in the early 2010s, more than 80 percent of luxury brands,²³³ including Prada and Gucci, closed some of their stores in China in 2015. The years since have seen Chinese spend come roaring back, but luxury brands will likely be more prudent this time around. Nevertheless, the reshoring of spending could see new store openings, particularly in key locations,²³⁴ such as Changsha, Shenyang, Wuxi and in China's virus epicentre of Wuhan.

The store network proposition is rather different for the mass-market fashion segment,

with Japanese fast-fashion giant Uniqlo going all-in for physical retail in China,²³⁵ even as rivals Inditex and H&M Group slash global store counts. Unlike many Western fashion chains, which have largely struggled to gain significant market share in China, Uniqlo has been winning in the country in large part due to its flexible approach to physical retail formats.

"The very wealthy consumers... have stayed in local markets and there is significant spend trapped there."

A look at the current situation in the Middle East suggest a potentially similar pattern to China, albeit on a much smaller scale. According to JLL's Elstob, stores in the region are benefiting from the repatriation of domestic spend as luxury consumers were unable to travel to Europe for much of 2020. "The very wealthy consumers... have stayed in those markets and there is significant spend trapped there," she said.

If the crisis leads to more permanent shifts in shopping patterns, then one implication could be that brands start to value their local stores in cities like Riyadh, Jeddah, Doha, Abu Dhabi and Kuwait City more than they did before the pandemic. Dubai, however, could follow a slightly different trajectory, according to Rania Masri, Chief Transformation Officer of Chalhoub Group, a luxury retail and distribution company headquartered there. "Tourism is very important for Dubai. Travel has had a big effect on us here [in contrast to the other Arabian Gulf consumer markets] that depend [more] on their local populations."

Anticipate the Changing Nature of Cities

People all over the world have been forced this year to change the way they live and work. As a result, both the function of cities and the relationship that consumers have with them are in a state of flux.

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“All of a sudden — whether we are talking about people in London, New York City or Shanghai — we feel untethered to that [urban] system [which has been prevalent since the industrial age]. So as I am able to work, or educate and entertain myself remotely, as opposed to feeling that I have to gravitate to any particular city centre or high street, then things change dramatically,” Stephens said.

Eight weeks after all shops were allowed to reopen in England after a three-month lockdown, footfall in London’s prime retail neighbourhood in the West End remained 63 percent down compared with 2019 levels, according to data from New West End Company, which represents 600 businesses across Oxford Street, Bond Street, Regent Street and Mayfair.²³⁶

Conversely, edge-of-town retail parks such as South London’s Brocklebank, have seen much better bounce-back, with customers finding the convenience of easy parking more appealing than using public transport. Fast fashion retailer Primark said its retail-park sales were up in 2020 significantly compared with the previous year.²³⁷

Suburban retail was already gaining ground over central locations, as affluent people preferred shopping centres and malls in well-off residential peripheries of emerging market megacities such as Moscow, Istanbul, Mumbai, Lagos and Jakarta.

According to Alexander Pavlov, chief executive of Tsum department stores in Russia, which are managed by Mercury Group, the Barvikha Luxury Village has seen high rates of growth in 2020. The retail complex, which features stores including Valentino, Celine, Chopard and Ralph Lauren, is located on the fringes of Moscow close to many of the dachas (second country homes) where the group’s wealthy consumers have been spending more time since the pandemic. “Fashion brands should put more focus and attention on the local market to increase their market share. Once the borders are open, clients will keep buying the brands that they got used to buying locally,” he said.

In Shanghai, 98 percent of the 2.65 million square metres of the total new physical retail space supply expected to be developed over the next few

years will be in secondary and decentralised areas of the city, according to figures from CBRE. This would leave only 2 percent for traditional “prime” retail areas.²³⁸ Highly anticipated new developments in the pipeline, such as Swire Properties’ 120,000-square-metre Taikoo Li Qiantan in the outer regions of Pudong district, are spread wide across Shanghai’s fringes.

Suburban retail was already gaining ground over central locations, as affluent people preferred shopping centres and malls in well-off residential peripheries of emerging market megacities such as Moscow, Istanbul, Mumbai, Lagos and Jakarta.

“The people who live in a community [now] tend to live, work and play in that community,” said Albert Chan, Director of Development, Planning and Design for Chinese real estate giant Shui On Land.

The same pattern is playing out in other parts of the world, where some of the most exciting new retail developments are being constructed outside of city centres, to cater to middle-class consumers with cars looking for shopping, dining, entertainment and community services in one place. The much-anticipated Capital Mall development in South Africa’s Pretoria West region, located at the intersection of several major motorways, is just one example.

Though this race to the suburbs may appear to be a mere replication of the outbreak of suburban malls in more developed markets, especially North America, the next generation of spaces could be markedly different if they are specifically designed to cater to their local communities in the post-pandemic era, rather than just taking advantage of cheaper land on the city fringes.

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“If you look at the complexion of shopping centres in the mature markets of the US and Europe... oftentimes they are monolithic centres [with] no real sense of authentic place.” Stephens said. “But [nobody needs] 200 of the same stores cookie cut across the land.”

However, according to JLL’s Elstob, the increasing importance of suburban and satellite city locations doesn’t necessarily mean that city centre locations become less attractive. “We are advising some clients that are looking to enter the New York market [to now] consider some more high-profile locations than they could have before because the terms available are better and they can get more incentivised deals,” Elstob explained.

Embrace the Impermanence of Built Environments

Not long ago, ideas about the use of built environments seemed permanent, but events in 2020 have taught us all to question any pre-conceived notions of permanence.

The new mantra is about flexibility and manoeuvrability, which is a concept that is often hard to square with the solid nature of bricks and mortar.

The notion that a brand should always select permanent locations for its retail portfolio — or even relatively permanent ones, locking itself into five- or ten-year leases before carefully re-examining its priorities — now feels antiquated. The new mantra is about flexibility and manoeuvrability, which is a concept that is often hard to square with the solid nature of bricks and mortar.

But with the only alternative being rows of empty storefronts marring the faces of cities around the world, landlords are likely to become more receptive to experiments and accept ephemeral concepts. In some markets, transient retail formats will probably move from being a

peripheral part of the retail environment to the very core.

In Shanghai, for example, a new, youth-focused mall which opened to the public at the end of 2019, TX Huaihai, has this ephemeral mentality at the centre of its lease agreements.²³⁹ According to company founder Dickson Szeto, who is in the process of opening half a dozen more TX properties around China, its malls will feature a rotation of brand pop-ups changing every three months in a bid to keep up with young consumers’ desire for newness.

“If I give a brand three years of space, I am taking a risk, but they are also taking a risk, so pop-ups are the best model for both parties.”

“If I give a brand three years of space, I am taking a risk, but they are also taking a risk, so pop-ups are the best model for both parties,” Szeto explained.

As consumers’ shopping priorities changed in 2020, executives realised that there is a degree of insecurity in every physical retail store, experience and format. No one knows for certain how long consumers’ new order of priorities will last or how they may evolve in 2021 and beyond, but a return to the pre-pandemic status quo is highly unlikely.

Whatever happens next, the key to building a successful physical retail portfolio will hinge not only on sophisticated and seamless digital integration for ultra-connected consumers, but on the ability of brand leaders to seize the moment in terms of location, format and next-generation strategies that generate good return on investment.

“I think, going forward, brands will and should become far more opportunistic in terms of where the brand appears, where it pops up, where it delivers experiences,” Stephens said. “It may be a question of having fewer stores, but fundamentally better stores.”



MAME KUROGOL

10. WORK REVOLUTION

Prompted by fundamental changes in the way companies worked during the pandemic and the need to drive performance in the years to come, an enduring new model for work is likely to emerge. Companies should therefore refine their blends of remote and on-premises work, invest in reskilling talent and instil a greater sense of shared purpose and belonging for employees who continue to reconsider their own priorities.

The pandemic has had a dramatic impact on fashion industry employment. Many jobs have been lost — and many more are at risk — across all industry functions, from the factory floor to stores on the world’s most exclusive shopping boulevards. In August 2020, the UK saw the lowest retail employment levels since 2009,²⁴⁰ while the US reported that more than 2 million retail jobs had been lost due to coronavirus.²⁴¹

Other factors could contribute to higher unemployment levels across the industry next year, as brands conduct store network reviews and companies in a variety of fashion industry sectors feel the pressure from tighter budgets. Luxury brands, for instance, have cut advertising spend by as much as 80 percent,²⁴² and US model agency revenues are estimated to see a 7.5 percent decline in 2021.²⁴³ Across functions, recent graduates and young professionals will continue to be severely impacted by the crisis as many job opportunities have either disappeared or remain on hold. And for those who do remain in gainful employment, many are witnessing profound changes to the way that they work.

In an industry where in-person interaction and long-distance travel have long been of paramount

importance, fashion companies have shown resilience since the start of the crisis by translating their traditional ways of working to the online environment. Social distancing measures and the inability to travel have accelerated the shift to digital in design, product development, buying, sell-in and more. Tools such as virtual sampling, digital material libraries and 3D rendering of collections for sales, which weren’t broadly used before the pandemic, have increasingly become the norm.

Fashion companies have shown resilience since the start of the crisis by translating their traditional ways of working to the online environment.

Similarly, the reinvention of trade shows and showrooms predicted in our “Unconventional Conventions” theme last year took off quicker than expected, as seen in the adoption of a number of innovations like digital trade hubs, marketplaces and fashion shows. For instance, 220,000 attendees joined the digital edition of key Latin America fashion fair ColombiaModa in July 2020, during which more

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than 4,000 digital appointments were scheduled.²⁴⁴ Some of the solutions offered by companies for these new formats are even being monetised. PVH's self-built virtual showroom Hatch, for example, has now become a standalone B2B tool which is offered to other fashion players.²⁴⁵

Around 90 percent of fashion executives anticipate that hybrid working will become the norm in 2021.

As the pandemic has called into question the role of the physical workplace, fashion companies must balance business efficiency with employees' needs and preferences, creating a new hybrid work model that supports organisational priorities. Around 90 percent of fashion executives answering our BoF-McKinsey State of Fashion 2021 Survey anticipate that hybrid working will become the norm in 2021 (see Exhibit 13).²⁴⁶ Hugo Boss announced in August 2020 it would allow employees to work remotely two days per week, following the results of an internal survey in which more than 90 percent of respondents had asked to switch to a hybrid model.²⁴⁷ In July, apparel group G-III was forced to postpone its date of return to the office after many employees complained about not being able to continue remote working.²⁴⁸

Work location, however, is just one of the many questions that fashion businesses must answer to prepare for the future of work. Another major challenge is the need for reskilling, as the pandemic has highlighted the importance of certain roles over others and certain areas of responsibility within roles. As entirely new skill needs continue to emerge next year, fashion companies will either have to develop them in-house or acquire them by recruiting. Fashion schools expect the weight of digital and analytics skills, for example, to increase significantly in their curricula, as a result of higher demand from fashion employees.

Interestingly, some of the skills gaps that exist within fashion companies may be filled by hardwiring remote working practices and thereby tapping into a global — rather than local — talent pool. Swedish underwear brand CDLP, for instance, already announced it plans to hire 50 percent of its staff outside of Stockholm, which means those employees could work remotely in fashion hubs like Paris, London and New York or much further afield.²⁴⁹ As proximity to the workplace becomes a less critical factor for employment, fashion firms also now have the opportunity to reach their diversity and inclusion (D&I) goals by overcoming location bias. With 27 percent of diversity efforts put on hold during Covid-19, fashion executives need to urgently revive D&I as a priority.²⁵⁰

As entirely new skill needs continue to emerge next year, fashion companies will either have to develop them in-house or acquire them by recruiting.

The talent mix is also likely to change next year. In the reskilling process, some firms may try to increase their workforce flexibility and limit employee costs by increasing their reliance on freelancers and contractors. Across industries, one Gartner survey showed that 32 percent of organisations were replacing full-time employees with contingent workers, as a cost-saving measure.²⁵¹ If the trend confirms itself this could lead to a further fragilisation of fashion workers, in an industry already highly reliant on contingent work in roles such as models, stylists and photographers.

Another area revolutionised by the legacy of the pandemic's restrictions will likely be the social role played by companies and the importance of the workplace in building social capital and maintaining social cohesion. The rise of digital nomadism — whereby employees can work from anywhere in the world and do not have one fixed workplace — is

FASHION SYSTEM

not optimal for all. Some people have suffered from poor mental health, loneliness and a lack of social interaction, as shown by a cross-industry survey ran by The Martec Group in which 42 percent of remote workers said their stress levels had risen since working from home.²⁵² The risk is even greater in an industry like fashion, where there has historically been a high reliance on interpersonal connections, networking and collaboration. In this context, the physical workplace could still play an important role in the future as a space for dispersed employees to meet in real life.

Regardless of the recovery timeline, the new operations of the fashion industry emerging from the crisis will be radically more digital than in the past and will require new pools of skills. The year ahead offers opportunities for fashion executives to introduce skill sets that drive value in their future business models. To benefit from the work revolution

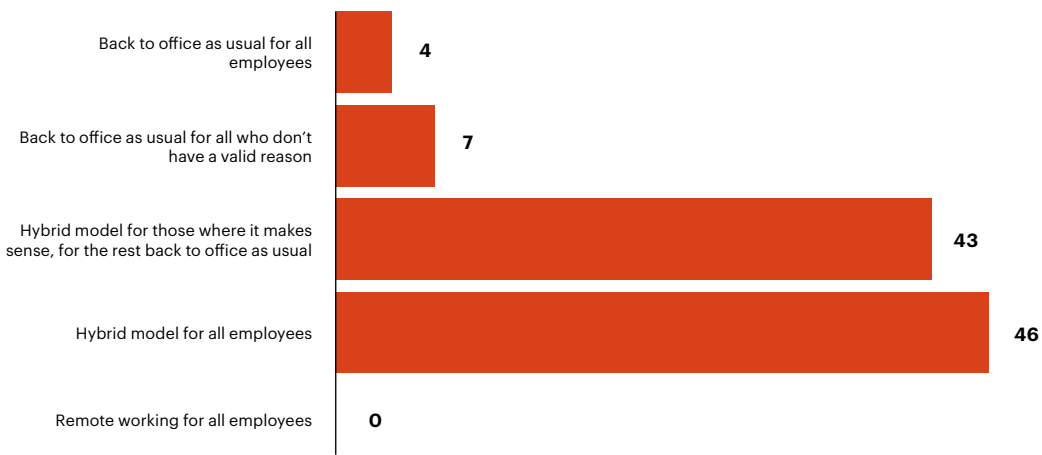
that the pandemic has accelerated, executives will also need to upgrade business processes in order to prioritise the recruitment and upskilling of talent to fill these gaps. The key for many fashion companies will be to invest not only in urgent training programmes but also in employees’ longer-term learning journeys.²⁵³

At the same time, C-suite executives should work with human resource departments to formalise a new hybrid model of working as soon as possible — one that achieves the right balance between stakeholder preferences and business requirements. Given the destabilising impact of the pandemic, fashion companies will be challenged to foster a strong collective spirit and organisational culture. To make sure that they do, company leaders will need to double down on their mission and values, while committing even more to representation in the workplace.

Exhibit 13:

Most fashion executives expect a hybrid working model to continue through 2021

% OF RESPONDENTS



SOURCE: BOF-MCKINSEY STATE OF FASHION 2021 SURVEY



THE STATE OF BEAUTY 2021



Why Beauty Will Make a Quick Comeback

The global beauty market is set to return to — and even surpass — 2019 levels in 2021, once again proving that it is more resilient than fashion, which is not expected to recover until 2022 at the earliest. But, like fashion, the beauty market that returns will reflect a changed landscape across regions, categories and channels.

by **Sophie Marchessou and Emily Gerstell**

Key Insights

- Recovery will be led by China, where sales have already rebounded. The US is on track to recover within the first half of 2021, while sustained declines in travel retail extend the timeline to 2022 for Europe and Japan.
- Fragrance and colour cosmetics faced steep declines in 2020, but beauty demand overall remains strong as consumers turn to the “self-care” categories of skincare, haircare and personal care — all of which face less disruption from new Covid-19 routines and lend themselves well to digital discovery and purchase.
- Brands and retailers are responding to the “new normal” in their product and channel strategies, with successful players focused on building direct, trust-based connections with the beauty consumer in an increasingly virtual world.

Pandemics do not alter history in as much as they accelerate it. This principle holds true for the changes witnessed across the global beauty industry, which saw nearly half a trillion dollars spent on beauty products in 2019. While beauty sales in the first half of 2020 declined by 10 to 30 percent, the sector — encompassing colour cosmetics, fragrance, haircare, personal care and skincare — is recovering.²⁵⁴ The reshaped market that will emerge out of the crisis, however, will reflect significant shifts across different regions, categories and channels.

These shifts are less a disruption of norms than a surfacing of trends already latent pre-crisis. With the exception of certain elements of beauty services and travel retail, many of these changes have played out on accelerated timelines, taking three to five months to materialise, rather than three to five years. Retailers and brands are rising to meet consumer demand and make the digital shifts needed in terms of product, commitments and purchasing experiences.

Recovery Speed and Character by Region

Inevitably, the recovery picture varies by region. Europe and Japan have been hit hard by their relatively low e-commerce penetration compared to other advanced economies and high exposure to the collapse of the \$40 billion travel retail beauty market.²⁵⁵ In the context of continued negative consumer sentiment about economic recovery and new waves of local lockdowns and permanent department store closures, we do not expect beauty sales in Europe or Japan to return to 2019 levels until the first half of 2022 at the earliest.²⁵⁶

China had already surpassed 2019 beauty sales by the first half of 2020, with an 8 to 10 percent average annual growth forecast between 2019 and 2021.

In contrast, China had already surpassed 2019 beauty sales by the first half of 2020,^{257 258} with an 8 to 10 percent average annual growth forecast between 2019 and 2021.²⁵⁹ This is partly due to the onshoring of some of the estimated \$30 billion that Chinese consumers previously spent on beauty when travelling internationally. China's beauty e-commerce market — which pre-crisis already comprised more than 40 percent of sales — has also continued to grow. Local “C-beauty” brands are leading the charge through innovative, agile and cost-effective digital go-to-market models.

Perfect Diary is emblematic of this, with its hyper-local influencer strategy and light-hearted “best friend”-style customer relationship management (CRM) focused on private traffic via WeChat and other direct channels to consumers — similar to how companies outside of China might use a blog or email.²⁶⁰ At the same time, international giants such as Estée Lauder Companies, L'Oréal Group and LVMH are also driving China's beauty rebound. So far their investments in China are

paying off, with L'Oréal Group reporting almost 60 percent growth of digital sales in China in the first half of 2020 compared to 2019.²⁶¹

In the US, by comparison, we forecast a return to pre-crisis beauty sales by as early as the first half of 2021, with an average annual growth rate of 3 to 4 percent between 2019 and 2021 — if the pandemic is managed effectively in the interim. Like in China, digital will drive recovery. Pre-crisis, e-commerce accounted for 20 percent of the US beauty market; by 2021, McKinsey estimates that penetration could accelerate to 35 percent. This chimes with our consumer research, which found that one-third of US consumers plan to permanently make e-commerce their primary purchase channel for beauty.²⁶² The ascendance of Amazon, which is on track to capture \$10 billion, or over 10 percent, of US beauty sales in 2020 (up from \$4 billion and under 5 percent in 2018) is a testament to this shift.²⁶³

While social shopping is in its infancy in the US, 17 percent of US Millennials report they have either started to purchase directly through social media or are increasing their purchases via that channel.

The shift to e-commerce for this sector is a global phenomenon: McKinsey predicts that the channel's share of the beauty market will effectively double from just over 10 percent in 2019 to almost 20 percent by 2021. It is also a function of increased engagement in social media, both as a purchase and a discovery channel. Instagram has made significant in-roads into commerce, including plans to test shopping on its Reels video product. While social shopping is in its infancy in the US, 17 percent of US Millennials report they have either started to purchase directly through social media or are increasing their purchases via

that channel.²⁶⁴ Many brands long-associated with Instagram, from Morphe to Charlotte Tilbury, have been quick to embrace Gen-Z-favourite TikTok, where users often showcase videos of themselves doing “challenges” in the form of a before and after video.²⁶⁵ Revlon’s #DoItBold challenge on TikTok, which invited fans to post content (not necessarily featuring Revlon products) that “tap[s] into your bold, bad self,” reached two billion views within three days of its October 16, 2020 launch.²⁶⁶

Category Comeback and the Shift to Self-Care

The overall return to pre-crisis levels in 2021 hides variations across and within categories. According to NPD, fragrance and colour cosmetics sales will likely continue to fall at an average annual rate of 12 percent and 2 percent respectively between 2019 and 2021.²⁶⁷ In contrast, haircare, skincare and personal care are predicted to grow in 2021.²⁶⁸

Going into the crisis, fragrance was already facing headwinds. Its biggest markets in Western Europe — UK, France and Germany, each worth approximately \$3 billion in 2019 — had declined 8 percent, 6 percent and 3 percent respectively in 2019 versus 2018.²⁶⁹ Disruption in travel retail (which accounts for approximately 20 percent of the total global fragrance market), in addition to fewer out-of-home occasions, the inability to translate olfactory experiences online, and a spending shift to scented premium bath, body care and home fragrances, all pose challenges to recovery of the fragrance category.²⁷⁰

Some niche, luxury fragrance brands have been relatively insulated by the strength of their home fragrance and bath and body business. However, these brands only represent a sliver of the fragrance market. Estée Lauder Companies reported in May 2020 that Jo Malone had doubled its home fragrance and bath and body business in China yet gains in Asia were not enough to offset an overall decline in the Estée Lauder group’s

fragrance business.²⁷¹ It follows that fragrance-focused players have been hit hard: Coty reported in August that quarterly net revenues in its prestige division dropped almost 75 percent.²⁷² While Interparfums saw net revenues drop over 70 percent in its second quarter, the company expressed optimism that it would be able to close 2020 with revenues down only 38 percent relative to 2019.²⁷³

Colour cosmetics had also experienced tempered sales going into 2020, after a growth streak between 2015 and 2018.²⁷⁴ Now, mask-wearing and the limitations of colour-matching online inhibit lipstick and face makeup sales. During the popular 618 shopping festival in June, China saw growth in the makeup category shift from lip products (the historic growth-driver of cosmetics in China) to eye makeup, which grew 159 percent.²⁷⁵ Across the globe, eye makeup has emerged as a relative bright spot, with NPD reporting 6 percent growth of prestige eye makeup in the US in the second quarter of 2020 relative to 2019. However, its growth cannot compensate for declines in the US prestige colour cosmetics category overall, which saw sales down by 52 percent in the second quarter.²⁷⁶

Across the globe, eye makeup has emerged as a relative bright spot, with NPD reporting 6 percent growth of prestige eye makeup in the US in the second quarter of 2020 relative to 2019.

But demand is not diminished entirely — it is just different — with growth coming from “self-care” products as consumers favour creams, masques, jade rollers and bath bombs. These categories are aligned with broader wellness trends and, crucially, lend themselves well to digital discovery and purchase. Across the globe, consumers indicate a growing preference for

THE STATE OF BEAUTY 2021

natural or so-called “clean” formulations, with 41 percent of German consumers and 30 percent of British consumers saying they prioritise this over a “stronger” formula.²⁷⁷

Consumers are also turning to personal care and skincare products to address conditions specifically related to Covid-19, whether that is to address dry hands, breakouts from mask-wearing (“maskne”), or puffy eyes from hours squinting at a computer screen while working remotely. Doctors around the world have noted a spike in patients experiencing stress-induced hair loss. New York-based LM Medical practice, for instance, has seen the number of patients seeking solutions for hair loss go from one patient a day to five a day. They have also seen a 30 percent increase in procedures, which facial plastic surgeon Dr Lesley Rabach attributes to “people taking advantage of downtime — the whole recovery process is covered by a mask.”²⁷⁸

When consumers do return to salons, they may be seeking different services and products more focused on embracing and enhancing their natural look.

DIY and the Return of Beauty Services

Throughout the pandemic, “do it yourself” products have also performed well. On Amazon, DIY categories of nail care and hair dye have seen growth of 300 percent and 200 percent respectively in the US relative to 2019 levels. To put this into context, this represents four to six times the growth rate of Amazon beauty overall.²⁷⁹ However, we anticipate that the majority of consumers will return to receiving beauty services in salons once they feel physically and financially secure enough to do so. In McKinsey’s June 2020 salon services survey, when asked why they were spending less, only 25 percent of consumers said it was due to

being satisfied with the results of DIY beauty. For consumers who normally frequent salons, the percentage who were satisfied with DIY results dropped to just 15 percent.²⁸⁰

Today’s consumer is more ethically minded, demanding that brands and retailers build their businesses with a conscience.

When consumers do return to salons, they may be seeking different services and products more focused on embracing and enhancing their natural look. “Natural” does not, however, mean no products or services — this is a “you, but better” look. Over one-third of consumers report they plan to spend less on chemical treatments permanently altering the hair’s texture, such as keratin treatments, perms or relaxants; instead they report plans to purchase services and products that will better nourish their hair, such as bond building treatments. The natural look has its limits though: Consumers’ intent to continue covering their grey hair remains undimmed.

In terms of price points, we have seen a shift towards more affordable products in the US and Western Europe, but this appears to be driven by store closures in prestige beauty channels rather than a lasting trend. Mass-market nail polish, facial moisturiser, cleanser and haircare all saw growth driven by price, not volume. In China, we have continued to see strong growth from premium and luxury segments as well as deep-discount focused “shopping festivals” — such as Singles’ Day and JD.com’s 618 sale — which drive disproportionate growth.²⁸¹

Conscious Consumption and a Call to Action

Today’s consumer is more ethically minded, demanding that brands and retailers build their businesses with a conscience. 2020 has seen a continued focus on sustainability, with

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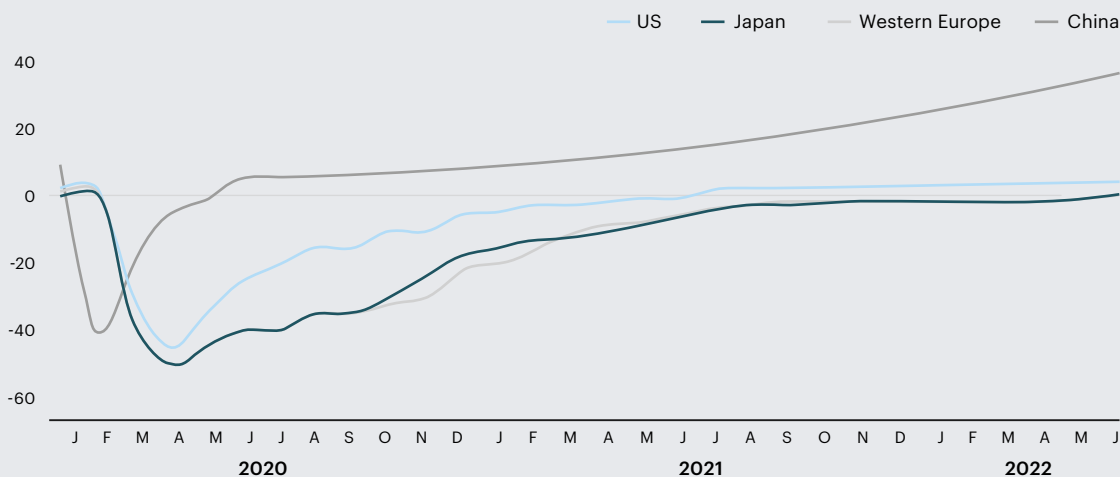
beauty manufacturers facing pressure from both consumers and shareholders to take action. What constitutes “sustainable,” however, is not clear-cut, as there is no regulation defining what it means to be “natural,” “clean” or “sustainable.” Retailers from mass market to luxury are responding by creating their own standards, with “clean beauty-only” retailers flourishing, from US-based Credo Beauty to Oh My Cream in France.^{282 283} While claims around sustainability are increasingly table stakes in the beauty business, consumers are not necessarily willing to pay more for it. Two-thirds of consumers in Germany and the UK consider a brand’s actions on sustainability to be an important buying factor, but only one-third of Germans and 16 percent of Britons are trading up their purchases to more sustainable brands, versus 46 percent and 36 percent of Germans and Britons, respectively, trading up for quality.²⁸⁴

The very public acts of racial injustice in the US and around the world in 2020 have also pushed the beauty industry to reflect on its role and responsibilities in shaping beliefs and behaviours. Consumers have called on global beauty giants to stop using promises of “whiteness” to sell products, citing the harmful stereotypes (if not ingredients) inherent in such claims. In the US, we are seeing companies join initiatives such as Aurora James’ 15 Percent Pledge (committing to dedicating at least 15 percent of their shelf space to Black-owned businesses)²⁸⁵ or Uoma Beauty founder Sharon Chuter’s #PullUpOrShutUp movement that challenged companies to go beyond words of support and be transparent about their actions. Beauty companies are recognising that being ethical and inclusive as organisations is both important and good for business — but that the industry has a long way left to go.

Exhibit 14:

China’s beauty market growth is expected to significantly outpace that of the US, Japan and Western Europe

BEAUTY MARKET SIZE YEAR-ON-YEAR PERFORMANCE VS. 2019¹, %



¹ Includes travel retail sales

SOURCE: FORECASTS FOR GLOBAL BEAUTY RECOVERY BY REGION, CATEGORY AND CHANNEL, REFLECT MCKINSEY PERSPECTIVE, MGI MACRO-ECONOMIC SCENARIOS AND NPd, NIELSEN, IRI, AMAZON STACKLINE AND PUBLICLY REPORTED COMPANY FINANCIALS FOR Q1 AND Q2 2020

Digital Discovery and the Changing Role of the Store

Retailers around the world are rethinking their assortments to meet changing demand. Not surprisingly, many are planning to expand their 2021 assortment in skincare and natural products, according to a survey of 50 US beauty merchants across mass market and premium beauty retail.²⁸⁶ They also plan to focus on “hero” SKUs (a brand’s bestsellers). As Fabrizio Fredo, chief executive of Estée Lauder Companies, said in the company’s earnings call in May 2020, consumers are proving more inclined to “seek brands and products they trust” while in-store retail remains challenged.²⁸⁷

Retailers are adapting their store strategy and re-thinking the role of the store in an omnichannel environment.

In response to these and other shifts, retailers are adapting their store strategy and re-thinking the role of the store in an omnichannel environment. Sephora announced plans in early February to open 100 community-focused stores in 2020, but, in October, the company revised its plan, to instead open 40 stores in 2020 and 70 in

2021. Sephora Americas CEO Jean-André Rougeot described the stores as playing an increasingly critical role as part of the end-to-end supply chain, not its end point. The retailer has plans to test using stores as quasi-warehouses to facilitate same-day delivery of holiday orders. In other words, the need for stores remains strong but the reason to go to the store is changing.²⁸⁸

Outlook for 2021 and Beyond

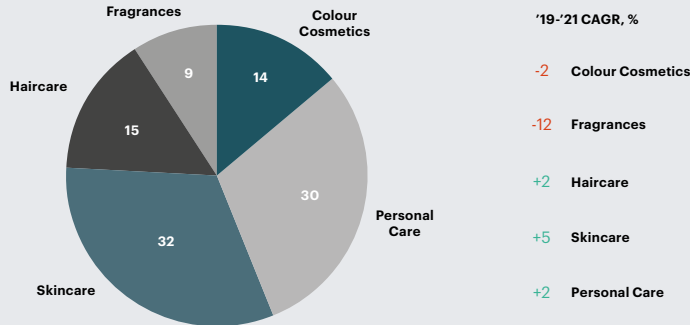
There is no question that 2020 has brought unprecedented challenges to consumers and companies around the world. Compared to other sectors such as fashion, beauty has been relatively insulated from the impact of Covid-19, as consumers continue to look to it as an affordable — and easily orderable — “pick me up” in a time of such duress. As beauty moves into a recovery phase, companies across the value chain — from manufacturers to retailers — will need to ensure they are flexible enough to adjust to category and regional opportunities, while maintaining or increasing their digital investments.

The authors would like to thank Danielle Bozarth, Sara Hudson, Aimee Kim, Clarisse Magnin, Jennifer Schmidt, Emma Spagnuolo, Marie Strawczynski and Yuanyuan Zhang for their contribution to this article.

Exhibit 15:

Shifts in the global beauty category mix are expected to last post Covid-19

CATEGORY DEVELOPMENT IN BEAUTY; % SHARE OF RETAIL SALES 2021¹



¹ Includes travel retail sales

SOURCE: FORECASTS FOR GLOBAL BEAUTY RECOVERY BY REGION, CATEGORY AND CHANNEL, REFLECT MCKINSEY PERSPECTIVE, MGI MACRO-ECONOMIC SCENARIOS AND NPD, NIELSEN, IRI, AMAZON STACKLINE AND PUBLICLY REPORTED COMPANY FINANCIALS FOR Q1 AND Q2 2020

Exhibit 16:

Digital gains almost 10 percentage points globally as consumers shift to online

CHANNEL MIX PRE- AND POST-COVID; RETAIL SALES, %



¹ E-commerce includes all online sales (i.e., marketplace, brand.com, retailer.com)

² Grocery includes convenience stores, forecourt retailers and supermarkets

³ Mass, club retailers include discount/warehouse and hypermarkets

Note: Due to rounding, numbers presented may not add up precisely to 100

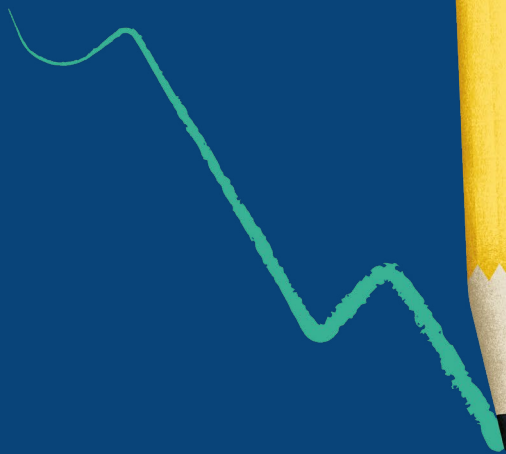
⁴ Beauty specialist retailers does not include any retailer.com's; these are included in e-commerce

⁵ Direct includes MLM (middle level marketing)

⁶ Other channels include hair salons, home shopping, apparel specialty, vending, etc.

SOURCE: FORECASTS FOR GLOBAL BEAUTY RECOVERY BY REGION, CATEGORY AND CHANNEL, REFLECT MCKINSEY PERSPECTIVE, MGI MACRO-ECONOMIC SCENARIOS AND NPD, NIELSEN, IRI, AMAZON STACKLINE AND PUBLICLY REPORTED COMPANY FINANCIALS FOR Q1 AND Q2 2020

MCKINSEY GLOBAL FASHION INDEX



Fashion Players Focused on Digital, Asia and Luxury May Have an Edge

With industry challenges continuing into 2021, how can players capture opportunities where they arise?

Key Insights

- After 4 percent economic growth in 2019, the events of 2020 devastated fashion industry performance with economic profit estimated to be down 93 percent year-on-year.
- Fashion industry value is now further concentrated among the top players — 60 percent of the industry was value-destroying in 2019, growing to an estimated 73 percent in 2020.
- Investors put their trust in internet retailers, companies that have a high proportion of sales in the APAC region, and companies that have previously been in our Super Winners list — implying the strong will get stronger in 2021 if stock valuations are a signal of future success.

The McKinsey Global Fashion Index (MGFI) offers a bird's-eye view of the fashion industry, tracking financial development and value creation through economic profit. Spanning regions, value segments and product categories, the MGFI is comprised of a proprietary data set of public companies whose predominant revenue streams are from fashion.

In this fifth edition of the MGFI, we continue our exploration of economic profit — a measure of value creation that comprises operating profit less adjusted taxes and cost of capital. The metric measures absolute value created over time, taking into account how much each company invests to generate its performance. First, we unpack historical

economic profit composition and development across the industry. We then explore the impact of Covid-19, which has caused a combined \$50 billion of value within the fashion companies studied to fall into a state of distress by September 2020. Finally, we look at stock market valuations and their implications for what it will take to succeed in 2021.

Looking Back at 2019 — The “Pre-Crisis Year”

The last edition of the MGFI showed that the majority of fashion executives across value segments and geographies anticipated an industry slowdown in 2020, after two years of growth in economic profit. The industry would continue to expand, but

Exhibit 17:

Industry economic profit is estimated to be down 93% in 2020 after growing 4% in 2019

TOTAL ECONOMIC PROFIT (2020 VALUE IMPLIED BY MARKET VALUATIONS),¹ INDEXED TO 2010 EP AS 100



¹ Long-term Economic Profit implied by 2020 market valuations, while assuming constant debt and WACC

² "Normalised" industry EP growth of 4% is based on the assumption that 58 companies with COVID-effects in their 2019 result (FY19 reported in March, April or May 2020), would have had similar growth to the rest of industry if their financial year aligned with calendar year 2019. The first half 2019 results support this assumption, as 58 COVID-affected companies had EBITA growth of 10% vs. 14% in the rest of industry

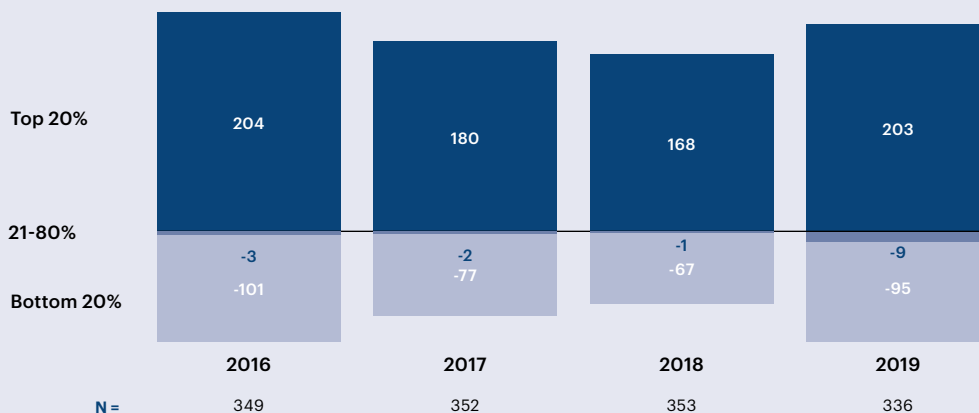
³ EBITA margin in 2019 is 10.3% when excluding 58 COVID-affected companies

SOURCE: MCKINSEY GLOBAL FASHION INDEX (MGFI)

Exhibit 18:

The "winner-takes-all" effect was magnified in 2019

FASHION COMPANIES' CONTRIBUTION TO INDUSTRY ECONOMIC PROFIT BY RANKED QUINTILE, %



Note: Due to rounding, numbers presented may not add up precisely to 100

SOURCE: MCKINSEY GLOBAL FASHION INDEX (MGFI)

at a slower pace, amid macroeconomic uncertainty, political upheaval and the threat of trade wars. Now, of course, the coronavirus pandemic towers above all challenges, and its economic impact will likely be felt for years to come.

In 2019, the fashion industry delivered an estimated 4 percent increase in economic profit, keeping it on the growth track that began in 2017, only at a slower pace.²⁸⁹ Drilling down into the growth number, revenues fell by 0.9 percent, offset by cost of goods sold (COGS) decreasing 3.2 percent, which resulted in a 6.9 percent increase in industry gross profit. However, a rise in other operating cost items created a net decline in earnings before interest, taxes and amortisation (EBITA). Finally, improvement in capital efficiency took capital charges down by 4.8 percent, turning economic profit to positive growth. The industry's EBITA margin in 2019 was 10.6 percent, compared with 10.9 percent in 2018.

The evolution of economic profit within performance quintiles tells a story that has now become an established narrative; namely that economic profit is gravitating further towards the most successful companies, leading to a widening gap between the "top and bottom." In fact, the polarisation trend accelerated in 2019, with the top 20 percent of performers by economic profit accounting for 203 percent of total industry profit. (The percentage figure above 100 is possible because so many companies contributed negative economic profit.)

The bottom 20 percent posted -95 percent of the economic profit, compared with -67 percent in 2018 and -77 percent in 2017. Only in 2016 was the industry more polarised, with the top 20 percent accounting for 204 percent of economic profit, while the bottom quintile generated -101 percent. In a continuation of the trend seen in recent years, the middle segment, representing the 21st to 80th percentile, failed to make a positive contribution to economic profit, in fact seeing its share slide to -9 percent, the lowest level since at least 2016.

Tracking the same data from a different perspective illustrates the extent of the industry's challenge. Some 60 percent of companies were value

destroyers in 2019, meaning they delivered negative economic profit. That was the highest proportion for at least a decade, compared with 55 percent in the three previous years, and consecutively decreasing amounts in the years going back to 2011, when just 26 percent of companies were value destroyers. In fact, the proportion of players that destroy value has grown steadily since 2011, causing the industry to move from a value-creating majority to a value-destroying majority. The high share of value destroyers could imply that some companies would struggle to re-finance if needed, as they cannot earn their cost of capital — likely leading to more companies facing financial distress in the future. Underlying this economic polarisation is a continuing shift in consumer behaviours, with the highly populated mid-market suffering at the expense of relatively few dominant luxury, value and discount players.

The First Half of 2020 — As Covid-19 Hit

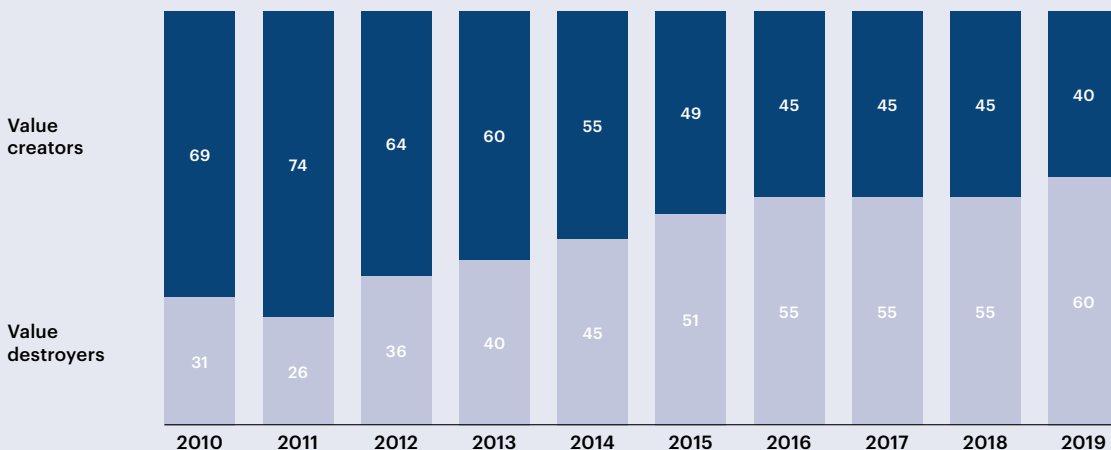
The Covid-19 pandemic has disrupted industry performance and will have a significant impact on the absolute value and trajectory of the industry's economic profit in both 2020 and 2021. Over the past 10 years, economic profit indexed to a value of 100 in 2010 has been in a range between 105 (in 2012) and 51 (in 2016) — though the latter was an outlier year with the next-lowest year being 2017 at 69. While performance year-to-year has varied, it has consistently remained within a fairly narrow range. The year 2020, however, is in a different league of underperformance. While full-year reports are not yet published, MGFI estimates based on market capitalisation development²⁹⁰ suggest that the industry's economic profit in 2020 will fall by 93 percent, after rising 4 percent in 2019. This would produce an index reading of just 6 compared to 100 in 2010, and far below the previous worst performance in 2016.

The resulting fall in economic profit will also be reflected in the proportion of value destroyers, which is estimated to rise to a record 73 percent in 2020, easily surpassing the 60 percent record level set in 2019, and almost three times the number

Exhibit 19:

The share of value destroyers in the industry grew to 60% in 2019

VALUE CREATORS VS. VALUE DESTROYERS PER YEAR, %

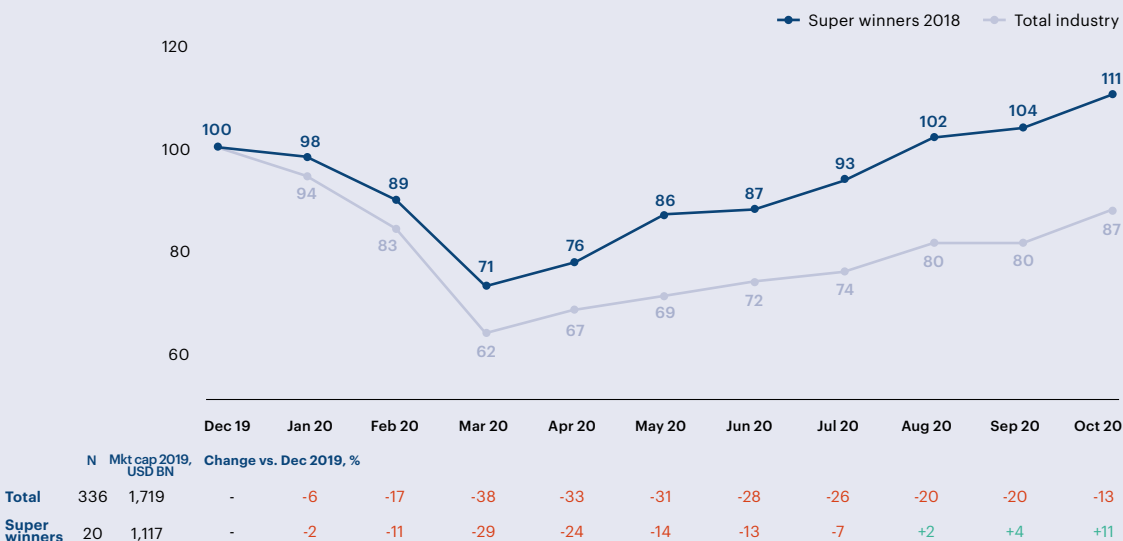


SOURCE: MCKINSEY GLOBAL FASHION INDEX (MGFI)

Exhibit 20:

Fashion's overall market cap plunged in March, while Super Winners continue to outperform

MARKET CAP FOR TOTAL INDUSTRY AND SUPER WINNERS, % DEC 2019 TO OCT 2020, INDEXED TO DEC 2019 AS 100



N = 336; Market capitalisation data for last trading day of each month, and October 23, 2020 (latest available at time of analysis)

SOURCE: MCKINSEY GLOBAL FASHION INDEX (MGFI)

seen in 2011. That would mean that out of the 326 companies in the index, 238 will be value-destroying, while the industry's positive profits will be divided between just 88 companies.

Analysis of quarterly revenues shows the devastating impact of the virus on industry performance. As the pandemic first began to spread quickly around the world, shopping for clothing was far from people's minds. Based on a dataset of 176 companies that reported quarterly results in April, May or June, revenues fell 34 percent compared with the same period in 2019, and EBITA margins fell 21 percentage points.

From a segment perspective, luxury and affordable luxury continued to do business, while value and discount took a hit, perhaps reflecting how the initial months of Covid-19 cast relatively less uncertainty over the spending of the wealthiest consumers. In the discount and value segment, the share of e-commerce is often low, influencing those companies' performance during the lockdown period.²⁹¹

In light of the long-term pressure on physical retail, and the relatively large proportion of fashion companies that came into the crisis losing money, it is not surprising that the shock caused by the pandemic was a step too far for many brands. Following a steady trickle of bankruptcy filings over the past few years, the trend accelerated during the early part of the outbreak, with more than \$30 billion of sales in the US under financial distress by September 2020. In Europe, the number totalled more than \$20 billion in sales in the same time period.²⁹²

However, there are some silver linings amid the clouds. While the impact of the crisis on businesses and jobs has been devastating, it may have accelerated strategic responses that turn out to be somewhat more positive in the long run. Several companies have taken the opportunity during the crisis to reshape and recalibrate their business models, often moving away from physical retail to digital-first or digital-only platforms.

Zara's parent company Inditex said in early summer that the group will close as many as 1,200

stores around the world (16 percent of the total). It then saw a surge in online shopping that helped it post a healthy profit, as digital sales jumped by 74 percent between February and July 31, compared with the same period in 2019 — the company at one point sold a million items in a day.²⁹³ Guess Inc. said in June that it was re-evaluating its brick-and-mortar strategy as coronavirus-related shutdowns continue to impact its business, revealing plans to permanently shutter about 100 stores in North America and China, or roughly 9 percent of its global network, over the ensuing 18 months.²⁹⁴

The scale of the challenge facing fashion companies is revealed by our McKinsey Fashion Scenarios analysis of financial distress and the impact of government subsidies. Without subsidies and other government support, the analysis shows that 75 percent of European companies would be in financial distress, based on the sample of 73 listed fashion companies from the EMEA region (Europe, the Middle East and Africa) with more than \$250 million in net sales. With partial subsidies and a weaker recovery, the proportion of distressed companies could fall to 58 percent or 52 percent with a stronger recovery. It is fair to expect that a supportive policy landscape will keep around half of companies above water, and will precipitate a wave of consolidation in 2021, as stronger players take the opportunity to pick off weaker rivals.²⁹⁵

Looking Ahead — Winning Traits

The forward-looking MGFI theme in last year's report was "apprehension and uncertainty." This year, the same sentiments apply. However, the analysis also shows signs of a slow recovery, with fashion companies beginning to adjust to the new normal and resetting their strategic ambitions. Average fashion company market capitalisations were at their lowest point in March 2020, with valuations 38 percent below their December 2019 levels. However, valuations have since started to slowly recover, and by October 23, 2020 they were down only 13 percent in comparison to December 2019.

Exhibit 21:

A stronger sales footprint in the APAC region helped brands through the crisis with relatively less severe lockdowns

MARKET CAP BY COMPANY APAC FOOTPRINT, DEC 2019 TO OCT 2020, INDEXED TO DEC 2019 AS 100

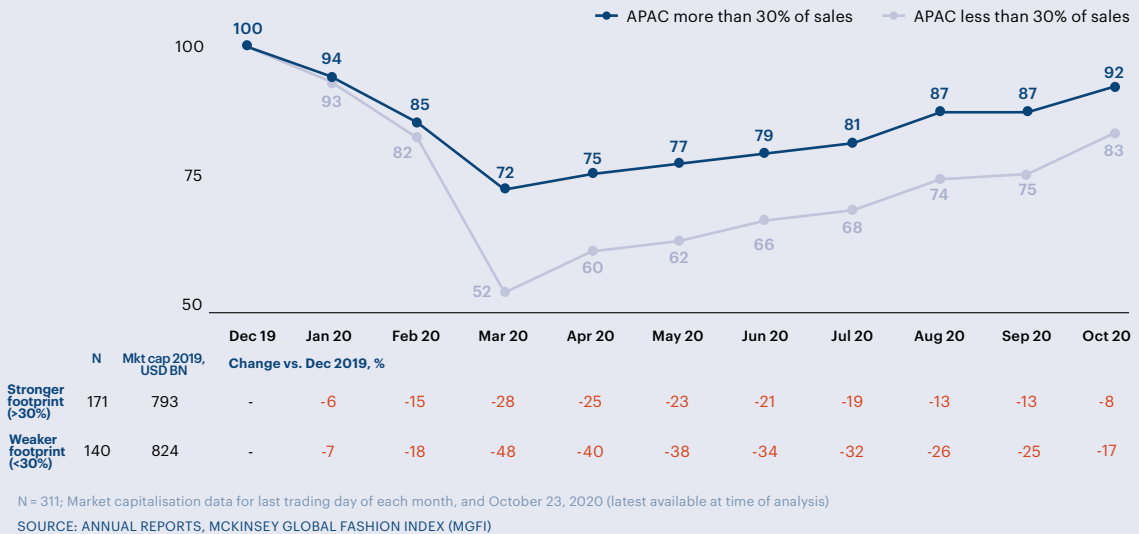
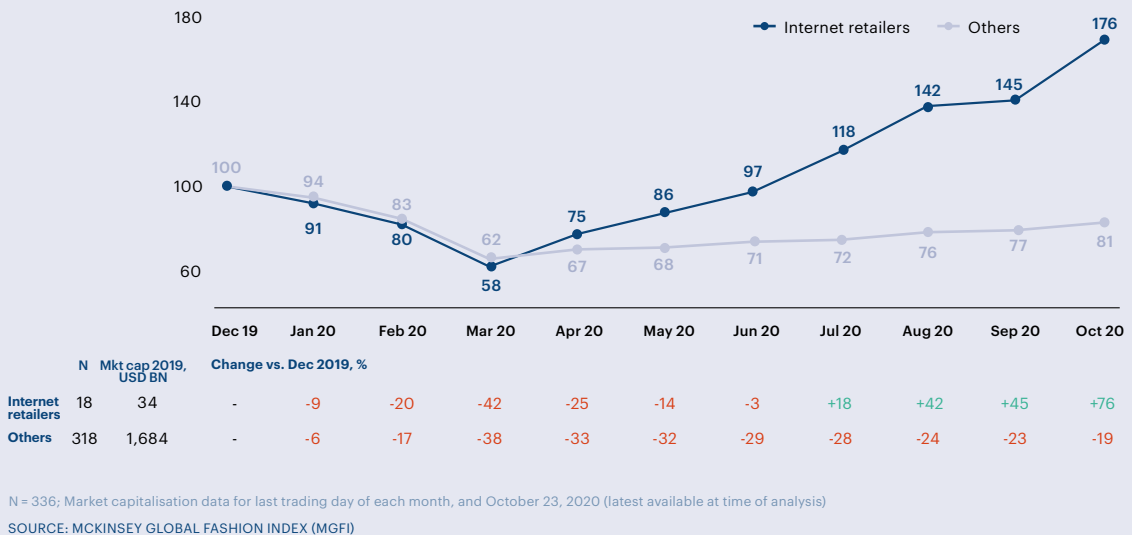


Exhibit 22:

Internet retailers took off after March in a V-shaped recovery, as prolonged lockdowns drove consumers to online shopping

MARKET CAP FOR INTERNET RETAILERS VS. OTHERS, DEC 2019 TO OCT 2020, INDEXED TO DEC 2019 AS 100



Perhaps not surprisingly, investors had more confidence in our list of top 20 fashion players by economic profit in 2018 (the “Super Winners” published in our last edition), reflecting a flight to well-known brands that meant the March 2020 stock market plunge was less severe for this group (down 29 percent from December, compared with 38 percent down for the total market on average), and by October the Super Winners had recovered to 11 percent past pre-crisis levels. Through the pandemic period, Super Winners performed better than their peers with 22 percent higher indexed stock valuations.

Companies that performed best in the months leading up to October 2020 shared two key characteristics. Many of them had a strong APAC focus, reflecting the economic strength of that region and the relatively smaller impact of the pandemic, and others offered a compelling digital proposition.

Looking at 311 fashion companies with revenue available on a regional level, those that had a sizeable (minimum 30 percent) share of sales in APAC consistently posted higher valuations — staying at on average 18 percent higher indexed valuations than companies with a weaker APAC sales footprint (less than 30 percent) in the period of January to October.

One persistent, and unsurprising, theme, is that pure play internet retailers such as Farfetch, Zalando, Asos and Revolve have consistently outperformed in 2020 as locked-down customers turned to their digital devices to shop. Despite initially seeing their market valuations decline alongside the wider market, these digital-first players picked up much faster from March, and by October were trading 76 percent higher than in December 2019. Across the January to October period, internet retailers on average traded 42 percent higher than other fashion companies (by indexed stock valuations), in the process lifting their share of total industry market capitalisation to 3.4 percent, up from 2 percent previously.

Looking at value segments, the analysis shows that value and discount segments surge to higher figures than others despite declining with

the market in March — they were 5 percent up from December 2019 figures by October 2020. Despite the previously mentioned relatively stronger quarterly results in luxury and affordable luxury, the segments have been showing valuations only marginally above mid-scale brands, with luxury and affordable luxury 14 percent below December 2019 levels in October, while the mid-scale brand segment was down 15 percent. It must be noted, however, that looking at luxury fashion companies only (excluding the affordable luxury segment), they show a more positive outlook and were down only 12 percent in October.

Taking a category perspective, sportswear has had a strong recovery, reflecting the accelerating “casualisation” trend. By October, the category was up 7 percent compared with December 2019. Jewellery and watches were the next-best performing category, suggesting that investors believe that consumers remained happy to make “investment” purchases during lockdown, even as their appetite for new clothes declined. The market capitalisation of jewellery and watch specialists was down 7 percent compared to their December 2019 valuations by October 2020. Clothing and footwear categories were down 18 and 19 percent respectively by October from their December 2019 levels.

While 2021 is likely to be challenging for almost all fashion companies, there will be opportunities for some. Those that find success are likely to continue to pivot to digital, understand where demand lies, and target better-performing geographies, segments or product categories. In challenging times, bold decisions often reap the richest rewards. However, decision-makers must also show they are able to respond quickly to a dynamic situation, while managing risk effectively, because the decisions they make over the coming months will be critical to the future of their business.

Editor's note: We are not releasing our list of the industry's Super Winners in this year's edition of The State of Fashion. Due to different reporting periods for 2019 financial year results, some companies have the impact of Covid-19 reflected in their results while some do not, and therefore does not provide us with apple-to-apple comparisons to rank companies on their performance this year.

GLOSSARY

1.5-degree pathway

A scientific estimate that indicates limiting global warming to 1.5 degrees Celsius would reduce the odds of initiating the most dangerous and irreversible effects of climate change.

3D design

Design enabled through software tools for virtual rendering and 3D visualisation of products with the ultimate goal of replacement for physical prototypes.

APAC (emerging)

American Samoa, Bangladesh, Bhutan, Brunei, Cambodia, China (including the Mainland, Hong Kong SAR, Macau SAR), Fiji, French Polynesia, Guam, India, Indonesia, Kiribati, Laos, Malaysia, Mongolia, Myanmar, Nauru, Nepal, New Caledonia, North Korea, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Tonga, Tuvalu, Vanuatu, Vietnam.

APAC (mature)

Australia, Japan, New Zealand, Singapore, South Korea, Taiwan.

Artificial intelligence

The theory and development of computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, decision-making and translation between languages.

Baby boomers

Demographic cohort born circa 1946-1964, following the "Silent Generation."

Biodegradable

Material capable of being decomposed naturally by bacteria when discarded as waste.

BoF-McKinsey State of Fashion 2021 Survey

Proprietary joint survey by The Business of Fashion and McKinsey. The survey asks international fashion executives and experts to rate their business sentiment, investment plans, and industry trends. 328 respondents participated in the State of Fashion Survey for the State of Fashion 2021 report between August and September 2020.

BOPIS

An omnichannel service enabling customers to order products online and pick them up in stores (buy online, pick up in store).

Capital efficiency

A measure of profitability used to assess how effective a company is at turning capital into financial performance.

Carbon neutrality

Balancing the level of carbon emissions with an equal level of carbon removal through the shift to new energy sources, changes in industry processes, circular business models and carbon offsetting.

Central Asia

Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan.

China's National Day (Golden Week Holiday)

China's National Day Holiday occurring over seven to eight days at the beginning of October celebrating the formal establishment of the People's Republic of China on October 1, 1949.

Circularity

An economic system aimed at eliminating waste and promoting the continual use of resources; minimising resource inputs and the creation of waste, pollution and carbon emissions. In apparel, we refer to the six Rs: reducing the materials needed and waste created when making products; recycling the materials used to produce new products; refurbishing deadstock and used products into new products – without re-processing the 'raw' materials; reselling second-hand or used products with no refurbishment; renting products through one-off rental or subscription models, and; repairing products, by professional or amateur means during the product's use-phase – without changing ownership.

Closed-loop recycling

A recycling process where post-consumer waste is collected and used to manufacture new products.

COGS

An income statement item stating the total costs used to create a product or service, which has been sold.

Concession models

Partnership model where brands use a retailer's space and benefit from its foot traffic in exchange for a rent or a sales commission. The model allows the brand to retain control over its image, customer experience and assortment, while it is less risky for retailers who do not purchase and manage inventory like in a wholesale model.

Consumer sentiment

An indicator that measures how optimistic consumers feel about their finances, the state of the economy and purchasing behaviour.

COVID-19

Coronavirus disease 2019 (COVID-19) is an infectious disease caused by

severe acute respiratory syndrome coronavirus 2 and was classified a pandemic by the World Health Organisation on March 11, 2020.

Deleveraging

The process of reducing a company's debt by paying existing debt and obligations on its balance sheet. Deleveraging allows companies to reduce the riskiness of their firm.

Digital material libraries

A central repository for all available raw materials and components of a product, enabling designers to have full visibility over the options they can use to complete a design.

Digital sell-in

A digital interface that is comparable to an online store, designed for showcasing products and order intake with B2B customers.

Earlier Recovery Scenario

Effective virus containment through vaccine and/or state intervention, leading to the lift of travel restrictions within a couple of months and enabling faster economic recovery, with global fashion sales returning to 2019 levels in the second half of 2022.

EBITA

An income statement item that deducts amortisation from earnings before interest and taxes (EBIT). An alternative measure of income a firm makes from its core operations.

EBITA margin

A measurement of a company's EBITA as a percentage of its total revenue.

EBITDA

An income statement item that deducts depreciation and amortisation from earnings before interest and taxes (EBIT). An alternative measure of income a firm makes from its core operations.

Economic profit

A measure of value created by businesses, whereby opportunity costs are deducted from revenues earned. A company creates value when its operating profit exceeds the dollar cost of capital. Economic Profit is defined as Net Operating Profit, less Adjusted Taxes (NOPLAT) minus Capital Charge (WACC multiplied by Invested Capital).

Europe (emerging)

Albania, Andorra, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey, Ukraine.

Europe (mature)

Austria, Belgium, Denmark, Finland, France, Germany, Gibraltar, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom.

EV/sales

A measure that compares a company's enterprise value to its annual sales. It is typically used as a metric that quantifies the purchasing cost of a company's sales. Enterprise value accounts for market capitalisation, debt and cash.

Extended Producer Responsibility

Extended Producer Responsibility (EPR) is a policy approach under which producers are given a significant responsibility – financial and/or physical – for the treatment or disposal of post-consumer products.

GDP

The total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period and thus serving as a measure of economic health.

Generation-Z

Demographic cohort born circa 1996-2012, following the Millennial generation.

GFA

Global Fashion Agenda.

Government support scheme / subsidy

Actions by governments to support small and large businesses during the Covid-19 crisis. Relevant government aid to brands and retailers includes rental support, salary support for furloughed staff, and loans on good terms.

Hybrid working

Flexible work structure in which employees can split their working hours between working from a central office and working remotely from their homes.

In-game skins

Outfit worn by a virtual avatar in a game; a selection of skins may be provided to the player for free or for a cost.

Inventory turnover

A ratio showing the number of times a company has sold and replaced inventory during a given period. A decreasing turnover implicates lower sales and potentially a build-up of excess inventory.

LatAm

Anguilla, Antigua, Argentina, Aruba, Bahamas, Barbados, Belize,

Bermuda, Bolivia, Brazil, British Virgin Islands, Cayman Islands, Chile, Colombia, Costa Rica, Cuba, Curacao, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guadeloupe, Guatemala, Guyana, Haiti, Honduras, Jamaica, Martinique, Mexico, Nicaragua, Panama, Paraguay, Peru, Sint Maarten, Suriname, St Kitts, St Lucia, St Vincent and the Grenadines, Trinidad and Tobago, Uruguay, Venezuela.

Later Recovery Scenario

Periodic virus resurgence in different regions of the world, resulting in new waves of lockdowns and continued restrictions preventing the start of the economic recovery, with global fashion sales returning to 2019 levels by the last quarter of 2023.

Livestream commerce

A service that combines live video streaming, the ability to interact with sellers and the functionality to buy products immediately.

Livestreaming

The broadcasting of an event or product offering (e.g., fashion show livestream).

M&A activity

The consolidation of companies through various types of financial transactions, including mergers, acquisitions, consolidations, tender offers or the purchase of assets.

Machine learning

A form of artificial intelligence that automates analytical model building, enabling systems to “learn” with minimal human intervention.

McKinsey Fashion Scenarios

Covid-19 recovery scenarios in the fashion industry across regions and segments based on holistic fact-bases and key sources of intelligence; includes fashion, accessories and shoes; last updated on September 23, 2020 as per Edition XII.

McKinsey Global Fashion Index

Proprietary and copyrighted McKinsey tool that provides a global and holistic industry benchmark for the entire fashion industry. The MGFI was first created for The State of Fashion 2017 to track industry performance through three key variables: sales, operating profit and economic profit. MGFI is composed of an extensive list of public and private companies spanning across market segments, product categories and geographies. The analysis of public companies is built with data from McKinsey Corporate Performance Analytics.

MEA

Afghanistan, Algeria, Angola, Bahrain, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Democratic Republic of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Iran, Iraq, Israel, Ivory Coast, Jordan, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Lebanon, Lesotho, Liberia, Libya, Madagascar, Malawi, Maldives, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Oman, Pakistan, Qatar, Réunion, Rwanda, Sao Tomé e Príncipe, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Swaziland, Syria, Tajikistan, Tanzania, Togo, Tunisia, Turkmenistan, Uganda, United Arab Emirates, Uzbekistan, Yemen, Zambia, Zimbabwe.

Microplastics

Very small pieces of plastic, typically less than 5mm in length, that pollute the environment. Their environmental harm is caused by their slow degradation, which occurs over hundreds if not thousands of years.

Millennials (or Generation-Y)

Demographic cohort born circa 1982–1995. Also commonly referred to as Generation-Y (this name is based on Generation-X, the generation that preceded them).

North America

Canada, Puerto Rico, United States of America.

Northeast Asia

China (including the Mainland, Hong Kong SAR, Macau SAR), Japan, Mongolia, South Korea, Taiwan.

Overstock

An excess in inventory, which has not been purchased by consumers.

Predictive analytics

Data analytics aimed at building predictions about future outcomes based on historical data and analytics techniques like statistical modelling and machine learning.

Price segments

As definitions of market segments often vary across sources, all companies in the MGFI are categorised based on a Sales Price Index, providing a range of prices for a standard basket of products within each segment and home market – thereby relying only on a quantitative measure, whereby companies in each segment price their items similarly.

QR codes

Matrix barcodes that contain information about the item or the location it is attached to and that can be read by smartphones.

Regenerated fibre

Fibre created from pre-existing fibres whose cellulose areas are dissolved in chemicals and rebuilt into new fibres by viscose method.

Return rate

Rate of product returns.

ROI

Return on investment assesses the benefit of an investment by comparing the cost of an investment to its return. For stores, this relates to comparing store investments and costs in store operations to the store's profitability.

S&P 500

The S&P 500 is a stock market index that tracks the stocks of 500 large-cap US companies.

SG&A

An income statement item stating all costs not directly tied to making a product or service.

SKU

Stock Keeping Unit.

SKU productivity

A measure of the effectiveness and profitability of an assortment by stock keeping unit against strategic and financial targets.

SME

Small and medium enterprises.

Social commerce

The use of networking websites and platforms such as Facebook, Instagram and Twitter to promote and sell products and services.

Southern Mediterranean countries

Albania, Andorra, Bosnia & Herzegovina, Croatia, Cyprus, Greece, Israel, Italy, Malta, Montenegro, North Macedonia, Portugal, San Marino.

Super Winners

The top 20 fashion players by economic profit according to The State of Fashion Report.

Sustainability

Within a business context, sustainability encourages businesses to frame decisions in terms of environmental, social and human impact for the long-term and relates to how a company's products and services contribute to sustainable development.

Travel retail sector

Retail located in travel hubs and key tourist destinations, such as

airports, airlines, cruises, train stations, downtown locations and border shops.

TRS

A measure of stock performance, factoring in capital gains and dividends to show the total return to shareholders. It is expressed as an annualised percentage.

Value creator

A company generating positive economic profit.

Value destroyer

A company generating negative economic profit.

Value segment

The company segmentation based on a Sales Price Index, which provides a range of prices for a standard basket of products within each segment and company's home market. The companies in the McKinsey Global Fashion Index and the BoF-McKinsey State of Fashion survey are categorised in six segments, which are based on a price index across a wide basket of goods and geographies. The segments comprise from lowest to highest price segment: Discount, Value, Mid-market, Premium/Bridge, Affordable Luxury, Luxury.

Virtual sampling

A digitised product development process in which designers create 3D virtual samples that are later shared with value-chain stakeholders in the product development and sell-in processes. This technology reduces time and cost from the traditional physical garment-making process, which requires shipping physical samples (e.g., for design approval or for sell-in).

Zero-based approach

An approach that seeks to link organisational designs to strategic priorities (e.g., areas for investment compared to efficiency optimisation) instead of a “one-size-fits-all” solution across the business.

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